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BUSINESSWEEK

OCTOBER 1, 2004

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ARCHITECTURE
WINNERS OF
2004
AWARDS

WALL STREET
EVE
TANNER'S
MEDIA
POWER BIZ

VESTING
WINNING YOUR
PORTFOLIO
FOR TAX TIME

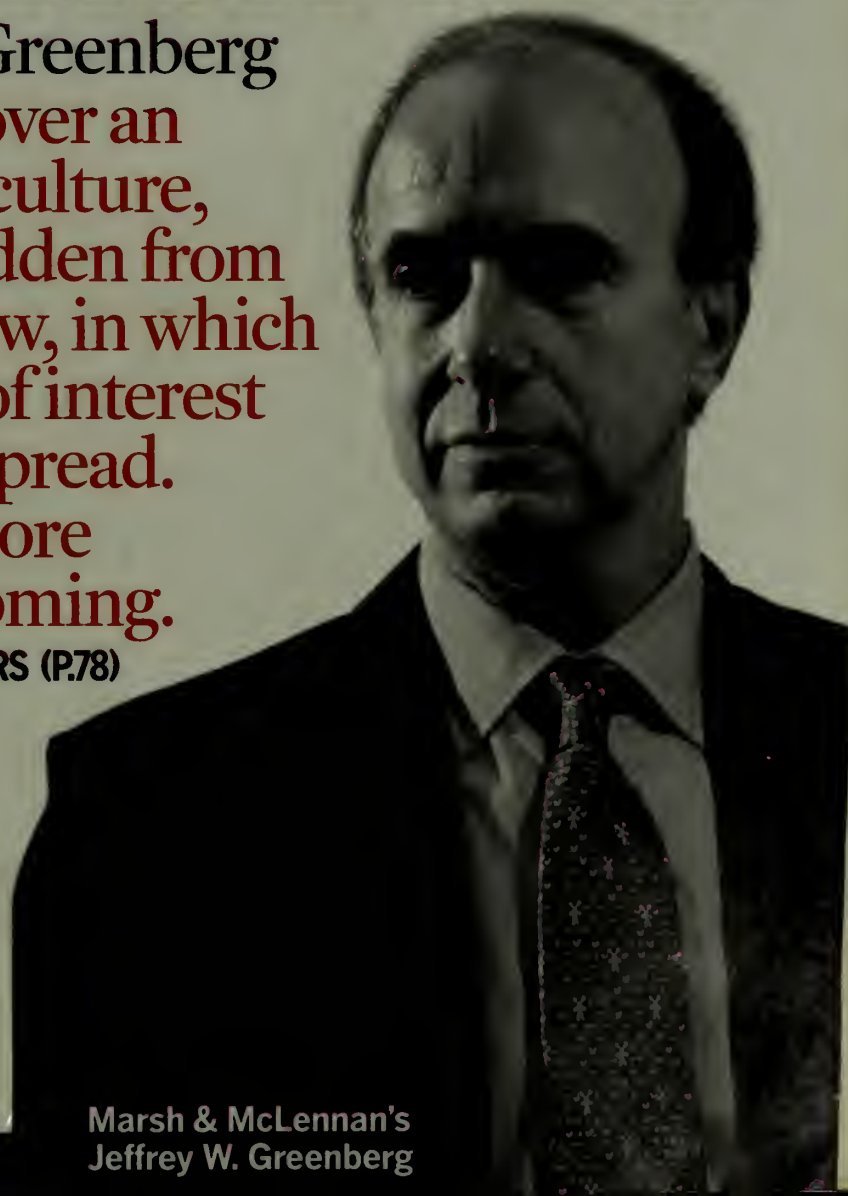
IN TECH
THE NEW
BATTLE FOR
THE DIGITAL
HOME

REAL ESTATE
THE CASH
SQUEEZE ON
BUILDERS

THE SECRET WORLD OF MARSH MAC

CEO Jeff Greenberg
presides over an
arrogant culture,
largely hidden from
public view, in which
conflicts of interest
are widespread.
There's more
trouble coming.

BY MARCIA VICKERS (P.78)



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Marsh & McLennan's
Jeffrey W. Greenberg



And, speaking of ingenious, the Odyssey has a new spin on space. Most models include a handy rotating Lazy Susan storage area, cleverly hidden in the second-row floor. It's perfect for stashing snacks, toys or just about anything you want to keep within easy reach.

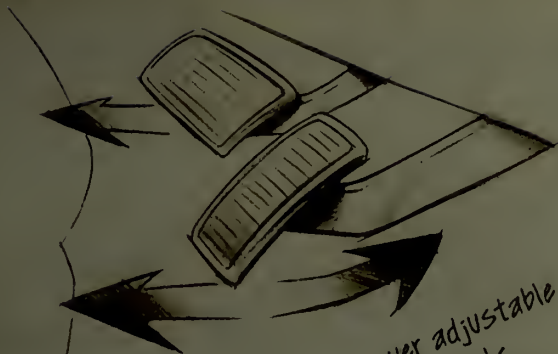
For added convenience, we've included power adjustable pedals on the Touring model. You can adjust the brake and gas pedals to give your Odyssey the perfect fit.

Of course, we've taken safety to a new level,

too. The Odyssey Touring model includes the new Michelin PAX[®] System. You'll have peace of mind knowing that, in the event of a puncture, you can still travel at 50 mph for up to 125 miles.

The all-new Honda Odyssey. Proof that, with the right thinking, even great ideas can be made better.



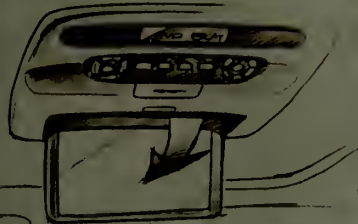


Power adjustable
pedals



Run-flat tires

Available 9-inch DVD screen



60/40 split
third-row seat



Easily folds flat



Lazy Susan
storage area
located in
2nd-row floor

Available voice-activated navigation



Screen folds down
to reveal CD changer





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*Darnell Jackson,
Merrill Lynch Financial Advisor*



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THE HEAT IS RISING

BusinessWeek has learned that MMC and its execs could face a raft of further legal and regulatory challenges



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Steve Jobs has conceived elegant high-tech products that have captured consumers' imaginations



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HOMOGENIZATION IS FOR MILK

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Wall Street Gets Comfortable With John Kerry

Fears of a selloff if the race remained close have not been realized. It's not that investors are pulling for the Dem as much as they're starting to think that if he wins, he won't be able to push much change

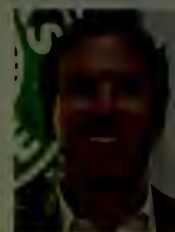


Info Tech Is Recovering—Bit by Bit

An improving economy is lifting semiconductors, but the telecom-equipment sector remains flat. Overall, Standard & Poor's industry ratings report card sees solid returns and improving credit quality, but no razzle-dazzle growth for 2004

A Full-Bodied Talk with Mr. Starbucks

As Chairman Howard Schultz plans to hand over the reins next year, he discusses the java chain's philosophy, its expansion strategy, and its biggest headache—the soaring cost of health care



Redmond's Cut-Rate Passage to India

Microsoft's recent announcement that it will introduce a low-priced Windows XP Starter Edition in Hindi, the dominant local language, has created quite a buzz in the subcontinent's PC market. But analysts can spot pirates on the horizon

The Online Music Business Hits a Flat Note

As more outfits enter the download market, the first tech-savvy users aren't being joined by a wider audience. Are more ads needed?



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KING GEORGE IV
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ENLIVET. It was illegal
at the time. "MILD AS MILK,"



and he would not
Luckily, he was
shortly after
legal by
James

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The single malt that started it all.

5

1

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JP Front

"We're twisting in the wind, we're airing our financial distress to the world."

—Brian Leitch, lawyer for US Airways, asking a bankruptcy court to approve a pay cut

EDITED BY IRA SAGER

RILLING DOWN

\$40 OIL? THAT'S HISTORY

ALMAN BOONE PICKENS, who came to prominence as an '80s corporate raider, has set big lately on rising oil prices—and won. His Dallas commodity fund is up 390% this year on his prescient prediction that oil would hit \$50. Here's what Pickens, 76, had to say, in a recent

barrels, as the Saudis have. To bring it up to [Saudi production levels], the cost would be somewhere around \$150 or \$250 billion. That's not that bad, in that you don't have to have an army and navy protecting it.

On drilling in the Arctic National Wildlife Refuge:

I say leave it for another generation. That's a two million barrel pipeline with 700,000 barrels in it right now. So all you could do is 1.3 million [more]. We're

importing daily 10 million barrels of oil.

On natural gas, which hit \$7.63 Oct. 20:

You're getting ready to see \$10 natural gas. The reason you know that you are is heating oil. Heating oil is in direct competition with natural gas, and it [has set record prices]. So you're headed in that direction, and

we'll probably get there [within] four months. So that will become a problem for the country.

On being a senior:

I don't take a salary [from fund management firm BP Capital]. You know why? I get my Social Security.

For a video with Boone Pickens, visit BusinessWeek.com/mediacenter



BALLOT BROUHAHA

An Uncivic Lesson in Ohio?

IS THE GOP TRYING TO HOLD DOWN the turnout among Cincinnati's Democratic voters to help President Bush carry swing state Ohio? Since 1980, local businesses have helped fund get-out-the-vote campaigns for a ballot initiative that pays 15% of the city's education budget. After failing to get the initiative pushed back to spring '05, the Cincinnati Business Committee, which includes **Procter & Gamble** and **Kroger**, is withholding its support—even though a defeat on Nov. 2 would whack \$32 million from the schools this year.

Local Dems charge that the GOP-friendly CBC is worried that the city's largely minority residents likely would pick Senator John Kerry if the initiative brings them to the polls. "That is my theory" for why business has yanked its support, says Cincinnati Board of Education President Florence Newell, a Democrat. The CBC says business acted because of unhappiness with the school board.

The battle is key because surrounding Hamilton County could determine the race of too-close-to-call Ohio, which President Bush barely carried. The county's suburbs tend to be Republican, but Cincinnati could carry the day for Kerry—if enough residents vote. *—Aaron Bernstein and Robert Berner*



meeting with *BusinessWeek* editors:

On where oil prices are headed:

I'll say it: \$60 before \$40. I think that will happen. I think we've seen \$40 oil for the last time.

On where the U.S. should get oil:

[Canada's Tar Sands] have the same reserves, 250 billion

DRUG WATCH

MEDIMMUNE: A MISSED SHOT AT THE FLU

WHEN CHIRON said it would have a shortage of flu vaccine this winter, it could have been a second chance for Med-



Immune. Last year it rolled out its FluMist

nasal spray vaccine to resounding disappointment. The price was high, it had to be stored in special freezers, and it was approved only for those between the ages of 5

ONE FLU OVER Not enough FluMist

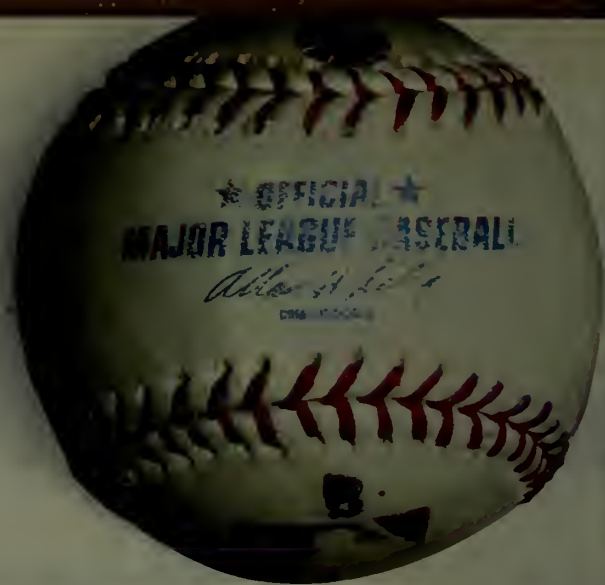
and 49, excluding the high-risk population that consumes most vaccines. The Gaithersburg (Md.) biotech sold only 400,000 of 4 million sprays produced.

MedImmune can't take advantage of Chiron's slip. It scaled back production this year to 2.1 million vaccines, compared with Chiron's 48

million shortfall. And it's hampered by the same lengthy production process.

Next year could be better, if Chiron stumbles again and MedImmune gets a federal contract to build a stash of vaccines. But two problems remain: tricky storage and restrictions limiting

FluMist to the low-risk group. Those won't be solved until 2007. By then, expect Chiron to be back on track and others to have footholds in the U.S. market. —Sarah Lacy



BALLPARK FIGURES

WHAT A CATCH The prized baseball Barry Bonds socked for homer No. 700 this season has turned up in a surprising place: the new auction site of Web e-tailer Overstock.com. The smudged ball, listed on the site along with used harmonicas and a pizza delivery bag, has proved attention-grabbing: **Two days after it was posted, bidding hit \$686,800.** The auction closes on Oct. 27. If Overstock's gambit is designed to drive traffic to its new site, it appears to be a grand slam: The first day of the Bonds sale, the company says traffic doubled. Who knows? Some of those visitors may even be bidding on a pizza bag. —Mark Hyma

GLOBAL ECONOMY OUTSOURCING: WORSE THAN YOU THOUGHT

U.S. EMPLOYERS have more than doubled the number of factory and white-collar jobs sent overseas since 2001, according to an Oct. 15 report by the U.S.-China Economic & Security Review Commission. It found that in the first quarter of this year, the annualized pace of job shifts topped 400,000, vs. 200,000 three years ago.

The study likely omitted many moves, especially white-collar jobs to China and India. Why? It's based on corporate announcements, which many companies have stopped because of bad publicity. —Aaron Bernstein

DRAWN & QUARTERED

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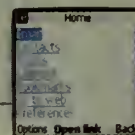
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CONNECTING PEOPLE

FACE TIME

WILLIAM RADUCHEL



MUSIC AND MOVIES—FREE AND LEGAL

Soon after advising a student named **Scott McNealy**, former Harvard professor **William Raduchel** got a call from him to join his up-and-coming computer maker, Sun Microsystems. For 11 years, Raduchel, 58, was a top adviser to McNealy. In 1999 he jumped to a mainstream consumer market, becoming chief technology officer of America Online. Now he's going after a less "mature" market—college kids.

On Oct. 18, Raduchel launched Ruckus Network to offer college students an online portfolio of songs and movies—legally. Students can get the service for free (if the school picks up the tab) or for below the typical \$10 per month for music subscriptions or \$4 per pay-per-view movie.

So far the startup has only a few customers, including Northern Illinois University, Alfred State College, and Bentley College. Says Raduchel: "We hope to have a million students in 18 months." If he does, Ruckus could live up to its name.

—Peter Burrows

SECOND ACTS

THIS PIGEON IS REALLY TAKING WING

IT'S TOUGH being a bicycle maker in China these days. The streets are crowded with cars, and cities have banned bikes from some thoroughfares. There's no shortage of competition, either: China was home to just a half-dozen bike builders in the 1980s but has 300 today. All that didn't stop Sha Yunshu from taking over **Flying Pigeon Bicycle**, one of China's most storied—and troubled—brands.

In the early 1980s, Flying Pigeon was the country's biggest bike builder, and there was a multiyear waiting list to get its 45-pound black one-speeds. In 1986, at the zenith of its prosperity, Flying Pigeon sold 3 million bikes. "In the planned economy, the market was guaranteed by Chairman Mao," says Sha.

Adam Smith has been less indulgent. As rivals moved

SHANGHAI
Bicycling is on a roll

toward ever-proliferating variations of racing, road, and mountain bikes, Flying Pigeon soldiered on with its sole black model. Sales plummeted like a wounded bird, to 200,000 bikes in 1998.

Today, Flying Pigeon is taking wing again. This year it expects to sell 1.5 million bikes, and revenues should be up 30%, to \$50 million.

The era of basic black is gone too. Flying Pigeons now come in 300 models and dozens of colors.

Even if bikes are no longer basic transportation—Sha ditched his for a **Honda Accord**—he is confident the business has legs. "More and more people will use bikes for leisure, not commuting," Sha says. If he has his way, they'll be doing both on Flying Pigeons.

—David Rocca

problem messages and give authors a chance to make revisions. The software, from New York-based **Orchestra**, creates a record that can prove intent if the author disregards the warning.

Subscribers will be able to tailor the monitoring feature to fit their needs or opt out.

But Nancy Flynn, an expert on e-mail risk, says they shouldn't. With lawsuits on the rise, monitoring internal e-mail

traffic isn't enough. Messages sent via third-party vendors such as Bloomberg also must be checked.

—Louis Lavelle

WEB WATCH

YOUR E-MAIL IS VERBOTEN. PLS TRY AGAIN

LOOK OUT, Wall Street, **Bloomberg** is watching. By yearend the financial news service will be monitoring millions of e-mails and instant messages that its 240,000 subscribers send each day, looking for insider trading, data theft—even porn.

Unlike other systems, Bloomberg's will stop



THE STAT

12

The percentage of U.S. adults who say they have had sex in their workplace. While 17% of men answer affirmatively, only 8% of women do.

Data: ABC News Polling; telephone survey of 1,500 adults



How things grow.

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CELEBRATING



As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

He Thinks Different

THE TECH WORLD gulped on Aug. 1 upon hearing that Steven P. Jobs had been operated on for pancreatic cancer. The Apple Computer Inc. co-founder and chief executive, who broke the news in an e-mail typed from his hospital bed, said his prognosis was excellent. Still, everyone from artsy Mac lovers to buttoned-down

Wall Street pros had to contemplate a future without one of the leading innovators of the Information Age.

Jobs's contribution? More than anyone else, he brought digital technology to the masses. As a visionary, he saw that computers could be much more than drab productivity tools. Instead, they could help unleash human creativity and sheer enjoyment. A marketing genius, he conceived of elegant products that captured consumers' imaginations. And as a relentless perfectionist, he came up with creations that actually delivered on their promise—raising the bar for rivals. “From the time he was a kid, Steve thought his products could change the world,” says Lee Clow, chairman of TBWA/Chiat/Day and Jobs' longtime ad man.

So far, 49-year-old Jobs has done just that three times. Soon after he formed Apple in 1976 with high school friend Steve Wozniak, the Apple II became the first PC to hit it big. While the power of computing formerly had been available only to techies, it was suddenly delivered to classrooms, dens, and offices. A quarter-century later, he rocked the music business with Apple's iPod music player and iTunes online store. This created a blueprint for the music biz in the Net era. And his Pixar Animation Studios was the first to show that computer animation could be used to tell imaginative, touching stories.

In many ways, Jobs's career is the definitive Silicon Valley story. Growing up with his adopted parents when the area was dotted with fruit orchards, he caught the tech bug early. He got his first job at 12 after calling Hewlett-Packard Co. President

More than anyone else, Steve Jobs has brought digital technology to the masses



Bill Hewlett and landing an internship. Using HP as their model, he and “Woz” focused only on breakthrough products. Apple's blockbuster initial public offering in 1980 made Jobs tech's first celebrity CEO. Then came the Mac in 1984. The first to pack new-fangled ideas such as icons, the mouse, and computer graphics into one easy-to-use machine, the Mac cemented Jobs's standing as a prodigy.

His youthful perfectionism nearly killed his career. When the original Mac fell short of expectations, he refused to alter its features and was booted from Apple in 1985. At his next company,

NeXT Inc., he created a \$10,000 PC that was packed with innovations, but too pricey for the market. More worrisome, Jobs poured \$50 million of his own money into the struggling Pixar.

His reversal of fortune began in 1995. Pixar's *Toy Story* became a box-office smash. Then, just months after Apple bought NeXT for \$400 million in 1996, Jobs took the helm of the foundering company. He quickly breathed life back into it with the lovable iMac. Then came the iPod in 2001, and iTunes in 2003—the first time anyone had convinced all the major record labels to sell their songs online.

Few doubt Jobs' management chops anymore. And with his prognosis looking good, he's back working part-time. “That was one of the things that came out of this whole experience [with cancer]. I realized that I love my life. I love [being with] my family, and I love [running] Apple and Pixar. I am very lucky.” Given his track record, so are the world's consumers. ■

—By Peter Burrows in San Mateo, Calif.

The more visible
you make your
supply chain,
the less vulnerable
it becomes.

The logo features a stylized 'V' composed of three overlapping diamond shapes. To the left of the 'V' is a large, red '3D'. To the right of the 'V' is the word 'Visible' in a white sans-serif font, and below it, the word 'Enterprise' in a larger white sans-serif font.

3D Visible Enterprise

Imagine if nothing was ever out of your sight. If you could see and track goods everywhere in your supply chain – in real time. You could re-route more quickly and reduce out-of-stock. You'd meet security issues and changing regulations more effectively. You'd have a clear, complete picture to streamline operations.

Announcing Unisys Global Visible Commerce.

The Global Visible Commerce Solution from Unisys starts with a digital 3D Blueprint to map interactions at every point in your supply chain. It traces cause-effect relationships through every location, transfer and customs requirement. You see "what if" scenarios and consequences to strategy. Your supply chain becomes more visible, so it's more predictable in a vulnerable world.

This solution works with other Unisys 3D Blueprints so you can become a 3D Visible Enterprise – where the future of your entire organization becomes more visible. And more predictable.

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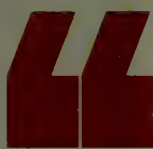
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Readers Report

BusinessWeek

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[Since] government-funded research is vital to our country...it's time the U.S. Treasury acted like a venture capitalist."

—Richard Brawer
Ocean, N.J.

Our 75th Anniversary Issue Special Report, "The Innovation Economy," generated many thoughtful letters. To those who wrote "Bravo," we say thanks. Other letters offered more ideas for changing the world.

CREATING AN INNOVATION POLICY

NONTECHNOLOGICAL innovations contribute as much to productivity and economic growth as technological innovations. Yet our innovation policy fails to recognize that fact. Yes, we have research-and-development and science-and-technology policies but not innovation policies. Nor do we have any direct measures of innovation activity. To start, we need a true innovation survey, similar to what the European Union and the Australians are trying to do. There are other areas where we can craft a true innovation policy, ranging from improving how we teach creativity to incentives to increase worker input into the innovation process.

—Kenan Patrick Jarboe, President
Athena Alliance
Washington

A RECIPE FOR PATENT REFORM

RE "ARE COPYRIGHTS" was chilling innovation?": The primary ingredients for

successful patent reform are threefold. First, more qualified people for software, biotechnology, and business-method patent examination are required to reduce the number of wrongful patents approved. Second, having a public review period after granting the patent—as opposed to before granting the patent, as some have proposed—would allow others to cite prior art yet allow the patent-application process to happen in secret. Third, patent law must be reformed to require holders to enforce their patents or risk losing them. Currently companies exist whose sole mission is to lie in wait for the widespread adoption of technology infringing on one of their older patents and then sue the companies with the most cash.

—Ryan Low
Riverside, Calif.

GIVE TAXPAYERS ROYALTIES

GOVERNMENT-FUNDED research is vital to our country. Since the money comes from taxpayers, I think it's time the U.S. Treasury acted like a venture capitalist. If something is invented using taxpayers' money, the Treasury should get a royalty for the life of the product. A system like that certainly would help all

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**Watch One From the Heart
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Readers Report

CORRECTIONS & CLARIFICATIONS

Our table of "The Best B-schools of 2004" ("The Best B-schools," Cover Story, Oct. 18) should have noted that Dartmouth College's Tuck School of Business (Hanover, N.H.) has 8% minority enrollment, not 4%.

leviate part of the deficit and may even help us avoid a tax increase in the future.

—Richard Brawer
Ocean, N.J.

HOPE FOR THE MIDDLE EAST

TODAY'S WORLD IS surging with change and innovation. Those who can cope with it will thrive, and those who cannot will fail. Your "75 years of covers" illustrates this graphically, in particular the "Act of War" cover on the World Trade Center attack and your cover on the '73 oil embargo. While the rest of the world was changing, and encouraging change, the Middle East was not. But with the seeds of liberalism now taking root in the Middle East, there are signs of hope that the great centers of learning that once existed there will rise again. It's easy to visualize a *BusinessWeek* cover featuring the Middle East as an Innovation Hot Spot.

—Tom Sherman
Michigan City, Ind.

AN UNTAPPED MARKET SECTOR

DESPITE SIGNIFICANT advances over the years, the disabled population continues to grow—56 million people in the U.S. alone ("Aging is becoming so yesterday."). Medical advances keep alive people who would not have survived certain injuries and illnesses in earlier times, and life expectancies are longer. Producing devices that bring people with disabilities into the economic mainstream will most assuredly generate income for companies smart enough to tap into this market sector. Americans with a disability have roughly \$180 billion in disposable income.

—Robert Cole
Bronxville, N.Y.

Editor's note: The writer is a former board member of American Association of People with Disabilities and has a daughter who is deaf.

FUZZY NUMBERS AND CREATIVITY

I COULD NOT ESCAPE the irony of reading through your Oct. 4 cover story "Fuzzy numbers" and then receiving the Oct. 11 issue on "The Innovation Economy," which contains the real answer to

accounting scandals and an environment that encourages unscrupulous behavior. The only creativity is in how to cut costs and make the quarter's numbers. As a result, we face losing our leadership position in innovation because these practices all but extinguish the spirit of innovation in an enterprise. We seem to be on the cusp of a paradigm shift: the old paradigm, with its emphasis on the short term, and a new one with a focus on wealth creation. But it won't happen unless we reward longer-term efforts.

—Philip E. H.
Lehigh Valley

ACCOUNTING AND EARNINGS AT SBC

BUSINESSWEEK GOT IT WRONG when it included SBC Communications Inc. "Pumped-up pension plays? (Financial, Oct. 25) about companies that are allegedly "pumping up" their earnings by manipulating retiree cost and investment return forecasts. Just the opposite happened at SBC: Changes in pension accounting assumptions last year rather than helped our bottom line, but a \$693 million bite out of 2003 net earnings. Our conservative accounting approach is reasonable and appropriate.

—Richard G. Linn
Chief Financial Officer
SBC Communications Inc.
San Antonio

Editor's note: SBC was cited as an example of how small changes in pension accounting assumptions can dramatically affect reported earnings. The story pointed out that in SBC's case, the adjustments actually lowered earnings in 2003. We did not intend to imply that the company's earnings were "pumped up" or questioned by the SEC.

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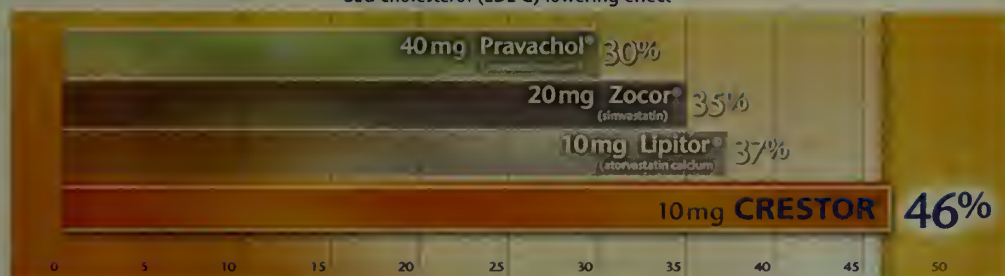
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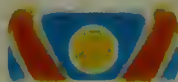
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Important information: CRESTOR is prescribed along with diet for lowering cholesterol and is not for everyone, including people with liver disease, and women who are nursing, pregnant, or may become pregnant. Tell your doctor promptly if you experience unexplained muscle pain or weakness, as they may be a sign of serious side effects. Be sure to tell your doctor about other medications you are taking. Simple blood tests are needed to check for liver problems before and 12 weeks after start of therapy or change of dose, and periodically thereafter. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away. CRESTOR has not been shown to prevent heart disease or heart attacks. See adjacent page for additional important information.

Source: Most commonly prescribed doses based on IMS (August 2003-July 2004).

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Please read this summary carefully and then ask your doctor about CRESTOR. No advertisement can provide all the information needed to determine if a drug is right for you. This advertisement does not take the place of careful discussions with your doctor. Only your doctor has the training to weigh the risks and benefits of a prescription drug.

BRIEF SUMMARY: For full Prescribing Information, see package insert.

INDICATIONS AND USAGE CRESTOR is indicated: 1. as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, nonHDL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable.

CONTRAINDICATIONS CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes).

Pregnancy and Lactation Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILD-BEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS** **Liver Enzymes** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN]) occurring on 2 or more consecutive occasions) in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter. Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS).

Myopathy/Rhabdomyolysis Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses of up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. Rare cases of rhabdomyolysis were seen with higher than recommended doses (80 mg) of rosuvastatin in clinical trials. Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. The incidence of myopathy increased at doses of rosuvastatin above the recommended dosage range. Consequently, 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine. (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (See DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 4. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 5. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures). **PRECAUTIONS** **General** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment ($CL_{CR} < 30$ mL/min/1.73 m²) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). Pharmacokinetic studies show an approximate 2-fold elevation in median exposure in Japanese subjects residing in Japan and in Chinese subjects residing in Singapore compared with Caucasians residing in North America and Europe. The contribution of environmental and genetic factors to the difference observed has not been determined. However, these increases should be considered when making rosuvastatin dosing decisions for patients of Japanese and Chinese ancestry. (See WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race).

Information for Patients Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions** **Cyclosporine** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean C_{max} and mean AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consid-

eration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis, and DOSAGE AND ADMINISTRATION). **Warfarin** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (4.4 baseline 2-3). In patients taking coumatin anti-coagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been documented, INR can be monitored at the intervals usually recommended for patients on coumatin anti-coagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anti-coagulants. **Gemfibrozil** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean C_{max} and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketonazole, spironolactone, and cimetidine. **CNS Toxicity** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallenian degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the

types of adverse events were similar in patients above and below 65 years of age. **WARNINGS** **Myopathy/Rhabdomyolysis** The efficacy of rosuvastatin in the geriatric population (>65 years of age) was comparable to the efficacy observed in the non-elderly population. **ADVERSE REACTIONS** Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies of 10,275 patients, 3.7% of patients discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences** Adverse experiences, regardless of causality assessment, reported in ≥2% of patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1. Discontinuations due to adverse events in the studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

Adverse event	Rosuvastatin N=744	Placebo N=382
Pharyngitis	9.0	7.6
Headache	5.5	5.0
Diarrhea	3.4	2.9
Dyspepsia	3.4	3.1
Nausea	3.4	3.1
Myalgia	2.8	1.3
Asthenia	2.7	2.6
Back pain	2.6	2.4
Flu syndrome	2.3	1.8
Urinary tract infection	2.3	1.6
Rhinitis	2.2	2.1
Sinusitis	2.0	1.8

In addition, the following adverse events were reported, regardless of causality assessment, in ≥1% of 10,275 patients treated with rosuvastatin in clinical studies. The events listed occurred in ≥2% of these patients. **Body as a Whole** Abdominal pain, accident/injury, chest pain, infection, pain, pelvic pain, and neck pain. **Cardiovascular System** Hypertension, angina pectoris, vasodilatation, and palpitation. **Digestive System** Constipation, gastroenteritis, vomiting, flatulence, periodontal abscess, at gastritis. **Endocrine** Diabetes mellitus. **Hemic and Lymphatic System** Anemia and eosinophilia. **Metabolic and Nutritional Disorders** Peripheral edema. **Musculoskeletal System** Arthritis, arthralgia, and pathological fracture. **Nervous System** Dizziness, insomnia, paresthesia, depression, anxiety, vertigo, and neuralgia. **Respiratory System** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Skin and Appendages** Rash and pruritus. **Laboratory Abnormalities** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. (See PRECAUTIONS, Laboratory Tests.) Other abnormal laboratory values reported were elevated creatine phosphokinase, transaminases, hyperglycemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and thyroid function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, hypersensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous rash, urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, photosensitivity reaction, myopathy, and rhabdomyolysis. **OVERDOSAGE** There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION** The patient should be placed on a standard cholesterol-lowering diet before receiving CRESTOR and should continue this diet during treatment. CRESTOR can be administered as a single dose at any time of day with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial) and Mixed Dyslipidemia (Fredrickson Type IIa and IIb)** The dose range for CRESTOR is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to goal of therapy and response. The usual recommended starting dose of CRESTOR is 10 mg once daily. Initiation of therapy with 5 mg once daily may be considered for patients requiring less aggressive LDL-C reductions or who have predisposing factors for myopathy (see WARNINGS, Myopathy/Rhabdomyolysis). For patients with marked hypercholesterolemia (LDL-C > 190 mg/dL) and aggressive lipid targets, a 20-mg starting dose may be considered. The 40-mg dose of CRESTOR should be reserved for those patients who have not achieved goal LDL-C at 20 mg (see WARNINGS, Myopathy/Rhabdomyolysis). After initiation and/or upon titration of CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted accordingly. **Homozygous Familial Hypercholesterolemia** The recommended starting dose of CRESTOR 20 mg once daily in patients with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. Response to therapy should be estimated from pre-apheresis LDL-C levels. **Dosage in Patients Taking Cyclosporine** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lipid-Lowering Therapy** The effect of CRESTOR on LDL-C and total-C may be enhanced when used in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency** No modification of dosage is necessary for patients with mild to moderate renal insufficiency. For patients with severe renal impairment ($CL_{CR} < 30$ mL/min/1.73 m²) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and not to exceed 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

NOTE: This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information and discuss it with them.

Rx only

Reference: IMS National Prescription Audit (August 2004).

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BY STEPHEN H. WILDSTROM

Putting Home Theater In Every Room

You have a fancy home-entertainment system that can record and play TV programs, DVDs, show digital photos, and tap into your collection of digital music. If, however, you want to enjoy all this anywhere other than the room where the system is set up, you're out of luck. Now, Microsoft has unveiled a solution—though it has some major limitations.

The offering is a black box called the Media Center Extender, which will work with any PC running the newest version of Microsoft Windows XP Media Center Edition (Oct. 18). You attach the Extender, available initially from Hewlett-Packard and Linksys for about \$300, to a TV set anywhere in your home and connect it to the Media Center PC over your home network. Seated in front of that television, you can now use a remote control to access all the entertainment functions of the Media Center: recorded TV shows, DVDs, photos, music—and of course, live television. If the Media Center has two or more TV tuners in it, you can watch one recorded show from your remote location while recording a second program. It's like getting a second TiVo but with more features and no monthly fee.

Setting up the Extender is a snap. You connect it to a TV, hook it up to your network, and turn it on. The box will find the Media Center PC on the network and generate a code, which you copy down and enter into the Media Center software. Once this is done, you see the same screens you would see on the Media Center PC and control the functions with the same kind of remote. About the only thing you can't do is record a DVD or physically swap disks in and out. And unlike the wireless networked audio receivers I reviewed in this column a while back (July 26), the extender installs easily on a secure wireless network. (For an update on audio players, see www.businessweek.com/technology/).

IT SEEMS JUST ABOUT PERFECT, but there's a problem, and it's the wireless network. Video requires moving a mighty stream of data, and the slightest glitches cause screen freezes. Microsoft's solution is a high-speed form of Wi-Fi wireless called 802.11a, which is immune to interference from cordless phones and microwave ovens. Fortunately, adding this capacity to a home network is simple. An access point or router that adds 802.11a to the more familiar "b" and "g" forms of Wi-Fi costs less than \$150 and takes no more than 30 minutes to install. I suggest you follow Microsoft's advice and confine your Web surfing and other PC-related traffic to your existing Wi-Fi channel, reserving 802.11a for the Media Center Extender.

This will not work for everyone, however. In many homes one access point is not going to provide coverage to every room with a TV. As a rule of thumb, if the signal has to travel through more than three walls, or two walls and a floor, it probably won't be fast enough. But there's no way to find out

THE GOOD PART
Media Center Extender is a snap to set up



for sure until you bring an Extender home, plug it in, and see if it passes its network speed test. If it doesn't pass, the options aren't great. There are "range extenders" for 802.11g but not for 802.11a. To complicate matters, for best results you want a

Microsoft's offering has many limits, but they may be fixed soon

wired connection between the Media Center and the access point. I've given up at home and installed Ethernet cables between rooms.

There are also content limitations. Extenders can't show high-definition TV. And some premium cable shows, notably on HBO, won't play because of copy-protection measures. Microsoft expects to have a downloadable software fix for this in November.

Despite its flaws, the Media Center Extender is a breakthrough product. At least for those who can meet its tough bandwidth requirements, it really does deliver on the much-promised convergence of entertainment and computing. And as home networks get better and easier, Media Center and the Extender will become an attractive option for more and more consumers. ■

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Books

Washington On the Couch

HIS EXCELLENCY: GEORGE WASHINGTON

By Joseph J. Ellis; Knopf; 320pp; \$26.95

The irony cannot have escaped Joseph Ellis: The historian who famously lied about his own past would investigate a man who, according to one legend, was incapable of telling a lie, George Washington. Ellis once told students, falsely, that he had been a star athlete, civil-rights activist, and Vietnam vet. Now

he would strip away Washington's mythology and give readers an unvarnished look at the hero of the war that enabled the U.S. to be born.

The result, *His Excellency: George Washington*, is a skillfully wrought volume that overcomes the general's aloofness and saintly status to get at the inner control freak and tortured moralist. Ellis boldly probes—and speculates about—such matters as Washington's formative experiences, romantic life, sources of wealth, and evolving repugnance toward slavery. But is Ellis' effort altogether valid history—or in part a fiction as imaginary as his tall tales about himself?

His Excellency homes in on hidden facets of Washington's personality—an area not accessible via the usual documentary evidence. The book does not attempt an exhaustive detailing of the great man's experiences or much discussion of the society in which he lived. In this, it resembles such previous Ellis works as *American Sphinx: The Character of Thomas Jefferson* (1996) and the Pulitzer Prize-winning *Founding Brothers: The Revolutionary Generation* (2000).

The author argues that the French and Indian War of 1754-63 helped shape several of Washington's basic convictions. He was along for General Edward Braddock's disastrous assault on the French garrison at Fort Duquesne, during which the Americans and Brits suffered 900 casualties, including Braddock, out of a total of 1,300 men. Colonel Washington lived to organize the retreat—and learned the value of simply surviving. Yet he bristled at British officers treating American troops as inferiors and paying them less than British regulars. Ellis' portrait of Washington as increasingly self-confident and resentful is persuasive until the author dons his shrink's hat and starts speculating. In Washington's hunger to command and his



iscomfort with any subordinate role, Ellis sees "bottomless ambition and the near obsession with self-control."

Washington's anger toward Britain escalated with his later experience as a plantation owner in thrall to a London mercantile house, says the author. By the 1760s, Washington had arrived in the top tier of Virginia's planter class. In addition to Mount Vernon and the considerable property he had inherited from his own family, Washington amassed an additional 18,000 acres of plantation land and hundreds of slaves through his marriage to Martha Dandridge Custis. But he soon began feeling that he had landed in a debt trap. Year after year the market for his chief crop, tobacco, seemed to worsen. Meanwhile, the prices for European goods seemed to soar. Washington complained bitterly, finally deciding that he had become dependent "on invisible men in faraway places for virtually his entire way of life," in Ellis' words. This, too, is compelling stuff, but the author can't leave well enough alone, adding that "if the core economic problem was tobacco, the key psychological problem was control, the highest emotional priority for Washington."

Ellis' 50-odd-page account of the Revolutionary War is engrossing. Like other historians, he concedes Washington's limitations as a military leader yet suggests that only his imposing presence held the Continental Army together. Ellis also takes us through Washington's short-lived retirement from public life, the convention that forged a federal constitution, and his two terms as President, during which he arguably "managed to levitate above the political landscape."

More interesting—and more telling about the Ellis method—is an account of the arrangements Washington made for the freeing of his slaves after his death. Here Ellis offers an alibi for which he seems to have little evidence: Slavery, the historian announces, had "haunted him in those last years," being "the one problem that he cared about most." How does Ellis know this? Partly because Washington avoided the subject in his letters and because he confessed to a friend that I do not like to think, much less talk about it." Aha!

Donning a shrink's hat, Ellis takes far too many liberties

The temptation to draw such doubtful conclusions—or describe the past as it might have been—is strong for all observers of history, notes University of Georgia historian Peter Charles Hoffer in another new book, *Past Imperfect: Facts, Fictions, Fraud—American History from Bancroft and Parkman to Ambrose, Bellesiles, Ellis, and Goodwin*. "Historians must be fabricators of a sort," Hoffer says, telling "stories about things they could not possibly know of their own experience." In his efforts to understand the Founding Fathers' motivations, Ellis

takes this a step further than most, says Hoffer: He becomes "a conjurer" able to see what's lost due to "the vagaries of missing documentation." Hoffer even goes so far as to suggest that it is Ellis' "power to invent truth"—much as he invented experiences for himself—that give his books their unusual force. It's not an approach Hoffer or the other historians he cites recommend, however.

So yes, *His Excellency* is at times insightful and even tasty—but some of it may be best taken with a grain of salt. ■

—By Hardy Green

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BY LAURA D'ANDREA TYSON

How Bush Widened The Wealth Gap

During the last half-century the distribution of income and wealth in America has become more and more unequal. Even during the 1990s, a period of sustained expansion, most of the growth in income and wealth was concentrated among the top 10% of households. By 2000 this group accounted for 44% of total household income, compared with 33% in 1980.

Today the top 1% of households receives more pretax income than the bottom 40%. And the distribution of wealth is even more lopsided. The top 1% of households owns nearly 40% of total household wealth—more than the bottom 90% of households combined—and earns half of all capital income. Income and wealth are more unevenly distributed among Americans than at any time since the Jazz Age of the 1920s. On measures of income and wealth inequality, the U.S. tops the charts among the advanced industrial nations.

YET RATHER THAN fashion economic policy to ameliorate the trends of growing income and wealth inequality, President Bush has championed policies that have exacerbated them. And if he is elected to a second term, he has put voters on notice that they should expect more of the same. A recent study by the bipartisan Congressional Budget Office confirms that the 2001 and 2003 Bush tax cuts have disproportionately benefited the wealthiest households. The tax cuts have boosted the aftertax incomes of the top 1% of households, with average incomes in excess of \$1,000,000, by 10%—compared with a 2.3% increase for middle-income families with average incomes of \$57,000 and a 1.6% increase for the bottom 20% of families, with average incomes of less than \$17,000. The tax cuts for millionaires alone have reduced government revenues by \$90 billion a year, more than the lost revenues from tax cuts for the 80% of families making less than \$100,000. Ninety billion dollars a year is more than enough to pay for the comprehensive health-care plan proposed by John Kerry and for the promises President Bush himself made but has not funded in his No Child Left Behind education bill.

As an intended consequence of the Bush tax cuts, the share of federal taxes paid by the bottom 80% of taxpayers has increased, while the share paid by the top 1% has dropped. And that's before the elimination of the estate tax scheduled to take effect at the end of the decade, which will further reduce taxes on the wealthiest households. President Bush has repeatedly announced that the main economic priority of his second term will be making his tax cuts permanent. If he realizes this goal, he will have succeeded in passing the most regressive tax program in U.S. history. He will also have chosen tax relief for the rich over strengthening the Social

Security system on which low-income workers, disabled workers, widows, and surviving children depend to avoid poverty. The tax code already favors those at the top. High-income households can afford to buy or build larger homes to take advantage of the tax deduction for mortgage interest payments. The top 20% of earners receives more than two-thirds of the benefits from tax deductions for private retirement savings. Most Americans are deeply in debt, and 95% can't afford to take advantage of such deductions. Yet President Bush wants to make them even more generous.

Employer-provided health-insurance plans also receive generous tax breaks, but less than half of low-wage workers enjoy such coverage, compared with 90% of high-wage workers. President Bush proposes a refundable tax credit for low-income individuals and families to help them buy health insurance. But according to the Kaiser Foundation, the credit is too small to enable most Americans to purchase coverage on their own. President Bush also proposes tax breaks for people who buy high-deductible health-insurance plans and who establish private health savings accounts to cover the bulk of their health-care costs. Under

his plan, all contributions, earnings, and withdrawals from health-savings accounts would be tax-free. This would be extremely attractive to high-income individuals but would raise the cost of traditional health-insurance coverage for lower-income and higher-risk populations. The inevitable result would be an increase in the number of uninsured and even greater inequality in access to health care.

If Bush is reelected, America will continue down the path of increasing inequality in income, wealth, and health, with dangerous implications for U.S. democracy. ■

Laura D'Andrea Tyson, dean of London Business School, chaired the Council of Economic Advisers from 1993 to 1995 and is an informal adviser to Democratic Presidential nominee John Kerry.

BY JAMES C. COOPER & KATHLEEN MADIGAN

Will the Latest Oil Shock Bring a Barrel of Woe?

Corporate America's response to weaker demand will determine the damage

U.S. ECONOMY

Remember the Soft Patch? That's how Federal Reserve Chairman Alan Greenspan referred to the consumer-led slowdown in the second quarter. The good news is the ground under the economy firmed up nicely during the third quarter, led by a strong rebound in household spending. The bad news: With oil at \$55 per

barrel, the record first hit on Oct. 15, get ready for Soft Patch II, playing at locations across the nation this winter.

As in the second quarter, consumers will have prominent roles in the sequel. Their spending will get pinched again in the fourth and first quarters, thanks to the double whammy of higher gasoline prices and home-heating costs. Gas jumped to \$2.04 per gallon in mid-October, only 2¢ shy of the May peak.

Global growth also is showing the impact of the oil shock. On the plus side, barring any major new supply disruptions, slower global growth—especially in China—seems likely to relieve some of the upward pressure on prices this winter. But until that occurs, the slowdown overseas is curbing demand for U.S. goods (chart).

Slower export growth and the impact of pricier petroleum imports are widening the trade gap, creating another subtraction on overall economic growth.

These drags from \$55 oil will work to reverse the momentum so evident over the summer. Economists, on average, expect the Commerce Dept.'s Oct. 29 report on real gross domestic product to show the economy grew at a robust annual rate of 4.2% last quarter. But forecasters have been revising their numbers for this quarter's growth downward. The latest *Blue Chip Economic Indicators* survey has an average fourth-quarter forecast of 3.7%, down from a 4.1% clip projected in July.

Bear in mind that the economy is in no danger of falling out—or worse. Many key economic indicators appear to have begun the fourth quarter at a high level compared with their third-quarter averages, including retail sales, which jumped in September.

Moreover, several production-related data would be stronger if not for September's hurricanes. The Fed noted the weather's impact when it reported a slim 0.1% rise in industrial output last month. And despite a 6% drop in September housing starts, new building permits rose slightly. All this means the numbers on payrolls, production, and housing are set to rebound in October.

THE CRUCIAL QUESTION is whether the current real GDP forecasts, already down from July, may be revised even lower. The answer depends greatly on the response of Corporate America. Companies, flush with cash and in

excellent financial condition, weathered the first soft patch well. They maintained a solid pace of capital spending and inventory growth. They even continued to hire, although at a reduced pace. The business sector's spring performance is what made the second quarter unfortunate for the recovery, but hardly worrisome.

This time, though, the headwinds will be stronger. No

CEO expected to be dealing with the implications of \$55 oil right now. On top of the uncertainties surrounding the Presidential election, Iraq, and future demand, oil at current prices is bound to change the calculus of spending decisions at a time when profits are slowing and costs are rising.



The two areas to look for signs that oil is landing a blow: capital spending and hiring. And so far the business community seems to be rolling with the punches. Morgan Stanley's monthly survey of its industry analysts in early October shows that among the companies they canvass, more businesses are hiring in October, and that more plan to hire over the next three months than in September. The survey also reports a slight increase in the number of companies who plan to hike their capital spending. Other data, such as orders for capital goods and first-time jobless claims, support these findings.

HOWEVER, A MAJOR DRIVER of future business decisions will be the trend in demand. Here is where oil will have significant impact. In the third quarter, households bounced back from the spring spike in gas prices. September retail sales jumped by 1.5%, thanks to strong car buying. Even excluding vehicles, sales were up 0.6%. The worry is that such solid increases will be hard to repeat this quarter and next.

Real household income is growing only about 2% this year. Job growth has to speed up to well above 150,000 a

month to lift wage and salary growth to a rate strong enough to sustain a healthy 3%-to-3.5% pace of consumer spending. And it's not clear job gains will reach that pace. Already, measures of consumer sentiment sagged in early October because of worries about jobs and oil.

In addition, economies worldwide have had to cut back on other spending to pay for costlier energy. As a result, weaker global demand is dragging down U.S. exports at a time when a weaker dollar and U.S. productivity gains should be making American-made products more attractive overseas.

Instead, exports are the main vulnerability in the trade outlook. Since May, when energy prices began to soar, the dollar value of exports has flattened out. The level is in sharp contrast with the 17.3% gain of the previous year. The slowdown is evident across most regions, especially in the emerging economies of Asia.

After adjusting for price changes, goods exports in August were up 10.8% from a year ago. That's down from May's 13.9% clip and it's below the 14.9% gain in imports over the past year. Worse still, further weakening looks likely. The Institute for Supply Management's survey of purchasing managers found fewer companies reporting gains in export orders in September, the sixth monthly drop in a row. The reading was the weakest in 17 months.

AT THE SAME TIME, the high price of oil coupled with strong demand here for materials and capital goods has pushed up U.S. imports. In August a one-time payment for Olympic broadcasting rights also added to the 2.5%

gain in imports while exports were basically unchanged. As a result, the trade balance widened sharply to \$54 billion, from \$50.5 billion in July.

It's important, however, to note that oil cuts two ways on imports. Yes, it's boosting the nation's total overseas bill. But since American consumers are devoting more of

their budgets to energy, they are spending less on other goods, and that includes imports. From May to August, the price-adjusted imports of nonauto consumer goods fell by 3.6%. Consumer-goods imports have not fallen for four months in a row since 1995 (chart).

At the Fed, oil is starting to command increased attention. In



speech on oil and the economy on Oct. 15, Greenspan said that costlier imported oil had already shaved about ¼ of a percentage point from U.S. growth so far this year. Adding, "the risk of more serious negative consequences would intensify if oil prices moved materially higher." He went on to say such a move seemed unlikely, although the world will have "to live with the uncertainties of the oil markets for some time to come." For now, it appears that this most recent oil slick has caused the economy to lose some of its footing. ■

ITALY

Conflicted Math in Berlusconi's Budget

ITALIAN PRIME MINISTER Silvio Berlusconi is trying to follow through on his pledge to lower taxes. But he must also keep the country's budget deficit from ballooning out of control. Achieving both goals will require a lot of belt-tightening.

The government says its budget plan will trim next year's fiscal deficit by \$30 billion and lower the 2005 budget gap to 2.7% of gross domestic product vs. an expected 2.9% this year. The euro zone's Stability & Growth Pact requires countries to keep budget shortfalls below 3% of GDP.

The budget doesn't include Berlusconi's \$7.5 billion in planned tax cuts for next year. Those will come via a separate finance bill,

expected by early November. That means holding the deficit under the 3% ceiling would require more spending restraint. Even if extra cuts are made, Raj Badiani, an economist at Global Insight Inc., sees next year's budget deficit hitting 3.3% of GDP, on top of a 3.0% shortfall in 2004.

Will the budget numbers add up? Public-spending growth is to be held at 2%. Meanwhile, regional and local

authorities will be allowed to hike taxes to cover shortfalls, which could undercut the benefits of Berlusconi's planned tax cuts.

More than \$8 billion of revenue is supposed to come from one-time moves such as state asset sales, but there are no guarantees the assets

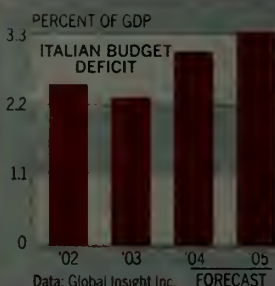
will fetch the expected prices.

What's more, the government has penciled in real GDP growth of 2.1% for 2005. Private economists expect 1.8% growth. Italy's economy appears to be dragging as high oil prices crimp demand. Factory output fell sharply in August, the second drop in three months.

Some measures are angering members of the coalition government. The Northern League is upset over a tax-evasion rule that would require an investigation of any small business or self-employed person who fails to declare a minimum level of income. To get Parliament's approval by the end of the year, Berlusconi may have to make concessions. But the Prime Minister has staked his political career on tax cuts, which means any changes are likely to come at the cost of a higher budget deficit. ■

—By James Mehring in New York

ECONOMISTS EXPECT MORE RED INK





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TELECOMMUNICATIONS

CABLE VS. FIBER

In the titanic battle to control the flow of data to U.S. households, the Bells fight back by offering video via phone lines

IN THE LONG-RUNNING contest for the digital future, cable has been hitting home runs while the telecoms are just coming to bat. In the last eight years, the cable guys have spent \$85 billion to tie fast digital pipes to the home. With their bolstered capacity, they offer hundreds of channels of video, movies on demand, high-definition TV, and, of course, high-speed Net access. And in their most direct challenge to the Baby Bells yet, cable providers are aggressively pushing digital phone service over their networks.

It's enough to give a telecom exec an anxiety attack. But now the Bells are gearing up to fight back. Just as the cable industry is going after telecom's bread-and-butter voice business, the Bells are about to wage war on cable's home territory: video. Their ace: Ultrafast fiber-optic networks that match or surpass the ca-

capacity of cable's digital system. On Oct. 21, Verizon Communications Inc. was expected to announce plans to build fiber systems in six Eastern states from Massachusetts to Virginia. Along with lines Verizon is already stringing in Texas, Florida, and California, the company expects to bring fiber connections directly to 3 million homes with expensive, state-of-the-art technology by the end of 2005. The estimated cost: \$2.4 billion. A week earlier, SBC Communications Inc. said it will accelerate its \$4 billion to \$6 billion fiber network build-out using less expensive technology; it plans to reach its goal of wiring 18 million homes, or more than half those it serves, by 2007.

The endgame isn't yet clear. Faced with the steep costs of fiberizing their networks, the two big telecoms haven't decided whether to try to match cable's reach: That industry already has the pipes

in place to serve some 90 million households nationwide. Even so, with the Bells' fiber push, two behemoth industries are locked in a titanic battle to control the flow of digital data to American households—be they TV signals, telephone calls, or Web pages. Today, those services are a \$134.5 billion market, according to researcher Yankee Group. But with fiber-enhanced bandwidth and the promise of services no one has yet dreamed of, that spending is almost sure to grow.

As early as 1996, with passage of the Telecommunications Act, many envisioned that cable companies would sell phone service and telecoms would sell TV packages. But only now, after many failed attempts in the last decade or so, are these industries truly going head-to-head: Cable can already serve all the homes Verizon and SBC want to equip with fiber.

The Federal Communications Com-

SO IN THIS SECTION:

40 GM must rethink its strategy

41 The Japanese push ahead in hybrids

42 The election indicators that really count

44 Homebuilders: Too much borrowing?

GLOWING PICTURE
HDTV, graphic-rich Web games, phone calls, and more carried on one hair-thin line

mission helped set off the contest with a series of decisions—most recently on Oct. 14—freeing the Bells to make massive investments in fiber without having to lease portions of their networks to competitors at a discount. Now, by replacing miles of old copper wires with superfast fiber, the Bells can deliver to consumers telephone dial tones, high-speed Web access, and, for the first time, TV shows, to fend off cable operators offering the same bundle. “We want to build a network that’s future-proof,” says Mark A. Wegleitner, Verizon’s chief technology officer. “Fiber is the right answer.”

UNDER ASSAULT

IT’S AN EXPENSIVE BET with no guaranteed return. Digging up streets and flowerbeds to install fiber is costly, ranging from \$300 to more than \$2,000 per home, depending on the technology, according to Carnegie Mellon University. Some telecoms have already lowered their sights. After failing to generate adequate returns by offering TV over fiber-to-copper networks in Colorado and Arizona, the No. 4 Bell, Denver-based Qwest Communications International Inc., is sitting out the current craze. CEO Richard C. Notebaert says he’s willing to install fiber only in new housing developments. “When you go in to do a tear-up or an overlay, the economics don’t work,” he says. Instead, Qwest is betting on upcoming WiMax wireless data transmission.

Other phone companies argue that they have little choice. With their core local-calling business under assault from wireless phones and now voice-over-Internet, the Bells’ local phone revenues declined by \$15 billion from 2001 to 2004—a drop of 7% a year—according to UBS Warburg. And now that Cablevision Sys-

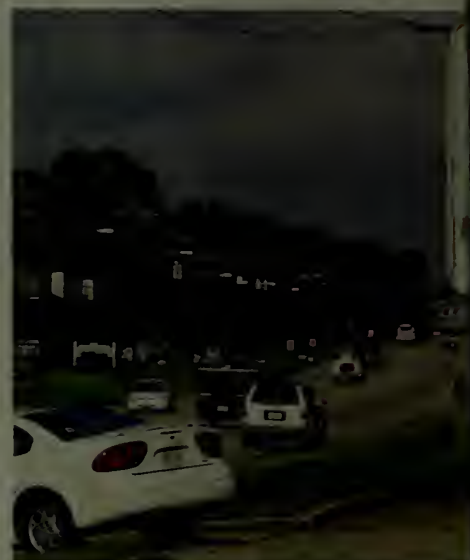
tems, Time Warner Cable, Cox Communications, and other cable companies are beginning to offer phone service over their pipes, the Bells’ losses will accelerate. By 2008, nearly 20 million subscribers will route their phone calls over cable, up from 2.8 million at the end of last year, according to estimates by market researcher IDC.

Even as the telecoms unspool their fiber, aggressive cable players are already feasting. Bethpage (N.Y.)-based Cablevision Systems Corp., which will go toe-to-toe with Verizon’s fiber-to-the-home rollout, was the first cable operator to offer voice-over-Internet to its entire 4.4 million home market in the New York City area last year. And Atlanta-based Cox provides phone service to 1.1 million of its 6.3 million subscribers by offering 10% discounts on local phone carriers’ rates. Tom Rutledge, Cablevision’s chief operating officer, predicts that “it’s going to take [the Bells] 10 years” to catch up.

That may be an exaggeration. Yet there’s little doubt the telecoms are struggling to stay in the race. Verizon has opted for an ambitious and costly plan—building fiber directly to the home at an estimated cost of \$800 per household. On its all-fiber network in Keller, Tex., Verizon is already offering a \$54.95-a-month package of phone and Internet service at speeds up to 30 megabits per second—about 10 times faster than most cable modems. Verizon claims it could hike that speed to a sizzling 100 mbps networkwide—though it won’t try until new applications demand it.

In contrast, SBC is taking the more cost-efficient option of extending fiber lines into neighborhoods—but not to in-

DOWN THE ROAD
Analysts say 20 million will get phone over cable by 2008



dividual homes. Cable operators take a similar approach, building fiber to neighborhoods and then connecting to homes using coaxial cable. SBC’s strategy, which costs about \$300 per household, uses a souped-up version of today’s DSL technology to speed signals across copper wires in the final stretch, delivering data to the house at up to 25 mbps. “I don’t know why a customer would need 100-megabit speeds that transfer the Library of Congress in a second,” says SBC Chief Executive Edward E. Whitacre Jr. No. 3 telecom BellSouth Corp. is implementing a similar strategy to serve about 1.3 million homes by next year.

NEXT STEP: CONTENT

NO MATTER WHERE the fiber ends, the Bells say their systems will thrill digitized households. The picture they paint: Sis and Mom could be watching separate bandwidth-hogging high-definition TV shows while Junior plays a graphic-rich Web-based video game and Dad chats on the phone. At the same time, a TiVo-like

Pipes Aplenty

The battle to provide digital TV, Web access, and phone service to U.S. households is heating up:

	FIBER-TO-CABLE	FIBER-TO-THE-CURB	FIBER-TO-THE-HOME
Speed	10 _{mbps} *	25 _{mbps}	30 _{mbps}
System	A combination fiber-optic and cable network.	Fiber optics to a local hub. Beefed-up copper phone wires are last link to homes.	Fiber-optic lines installed directly into homes.
Services	Internet access, phone, and 500 television channels in addition to HDTV and video-on-demand.	Integrated Net access, phone, and video on one screen, plus interactive services that give viewers control of such things as camera angles.	Offerings similar to planned SBC service plus videophone capabilities. Many applications yet to be determined.
Build-out cost	\$1,200 per household.	\$300 per household.	\$800 per household.
Status	Coming to about 90 million households for \$90 to \$150 per month.	Available to 18 million SBC customers by late '07. BellSouth plans a more limited build-out. Price comparable to cable.	Available to 3 million Verizon homes by late 2005. Price also in line with cable.

* megabits per second

Data: National Cable Television Association, Yankee Group



device could be recording two other HDTV channels.

Cable execs say they can match that, but the Bells claim their technology gives them an advantage. Rather than broadcasting 500 channels at once to a mass audience, as cable does, the Bells will store programming at a central server to send upon an individual user's request. The result, the Bells say, will be personalized content for micro-audiences: a local high school could load video of its football games for Moms and Dads to view, when they want, in a specific town.

Sounds nifty. But to make money, the Bells will have to offer top-tier entertainment. Both Verizon and SBC will launch cable-like TV services next year. Verizon has hired cable-programming exec Terry Denson from Insight Communications Co., the ninth-largest cable company, to line up programming. And Verizon's partnership with satellite provider DirecTV Group and SBC's with Echostar Communications give each a taste of the TV biz. Yet the telecoms may be in for a rude surprise. Media execs note that delivering *Desperate Housewives* is a lot trickier and costlier than delivering a dial tone. Says Time Warner Inc. CEO Richard D. Parsons: "Content is expensive."

Whether or not the Bells ever make money with TV offerings, it's clear that Web-surfing, phone-addicted couch potatoes will be the big winners. With both cable and phone companies offering everything digital all the time, consumers will be bombarded with more choice—and maybe even lower prices. Imagine that. ■

—By Catherine Yang in Washington, with Tom Lowry in New York, Roger O. Crockett in Chicago, Peter Burrows in San Mateo, Calif., and bureau reports

HOLLYWOOD

Mini-Crowds At the Multiplex

The most eagerly anticipated holiday movie this year features an out-of-shape ex-superhero living undercover as an insurance adjuster. But for

some Hollywood execs, the story line for Pixar Animation Studios' *The Incredibles* is striking close to home: After years of bulking up, audiences at the nation's theaters are starting to look a mite puny.

Even as Hollywood boosters

insist that the year will end strongly, attendance at U.S. theaters looks set to fall.

Although Hollywood is loath to talk about it, the industry is in a funk. This year just 14 films have grossed more than \$100 million at the box office, vs. 21 a year ago, according to Web site Boxofficereport.com. Even with blockbusters *Shrek 2*, *Spider-Man 2*, and *The Passion of the Christ*, revenues from ticket sales so far this year are up a mere 2%, to \$7.5 billion, says industry tracker Exhibitor Relations Co. And with Christmas on the horizon, the usual goody bag of muscular action films, sweeping dramas, and rib-shaking comedies seems thinner than usual.

Indeed, moviemakers have only higher ticket prices to thank for even the small gains they've seen. Attendance is down for the second straight year: After falling 4% in 2003, Exhibitor Relations says it's off 1.5% more this year. Heavily hyped flicks such as

Paramount Pictures' puppet film *Team America: World Police* and Fox's comedy *Taxi*, starring Queen Latifah, have so far disappointed. That's fueling concerns that movie audiences, like TV viewers, are drifting away to their PCs, DVDs, and video games. Worse yet, a single night of Web surfing can kill a film, says Nielsen

Entertainment. It found that getting panned by a site such as Rotten Tomatoes can erase the usual 20% hike a film gets from Friday to Saturday.

All that makes the task of creating box-office hype ahead of opening day more crucial than ever. To promote *The Incredibles*, Pixar and its distributor, Walt Disney Co., started joint promotions with SBC Communications Inc. more than a

month before the computer-generated flick opened.

Paramount has been airing nearly wall-to-wall ads on its Nickelodeon cable channel for *The SpongeBob SquarePants Movie*, which comes out on Nov. 19. To open *Shark Tale*, one of the fall's few hits, DreamWorks SKG spent lavishly for prime-time TV spots and staged a star-studded outdoor premiere in New York's Central Park. And some studios are beefing up their online presence to lure

folks in from the Net: Disney is showing a 10-minute segment of its Indiana Jones-like action film, *National Treasure*, starring Nicholas Cage. "People have other things to do with their lives, and our job is to bring 'em back," says DreamWorks marketing director Terry Press.

The formula is simple enough. Says Chuck Viane, distribution president for Disney: "We just need a four quadrant film, one like *Titanic*, that appeals to young and old, men and women."

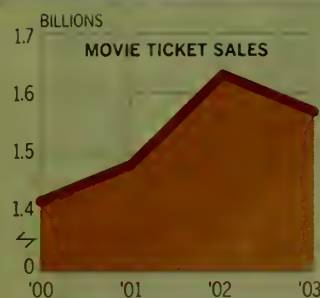
Hollywood thinks it has the goods, including *The Incredibles*, sequels to hits such as *Meet the Parents* and *Oceans 11*, plus extravaganzas such as *Alexander* and comedies such as *Christmas with the Kranks*. They'll need them all to resonate if they hope to turn the box office back into a superhero.

—By Ronald Grover in Los Angeles



The Incredibles

UNHAPPY ENDING?



Data: Motion Picture Assn. of America, Exhibitor Relations Co.

COMMENTARY

BY DAVID WELCH

GM: A Dangerous Skid

With profits crashing, it might have to cut production lines and capacity

GENERAL MOTORS Corp. Chairman and Chief Executive Officer G. Richard Wagoner Jr. never thought the price war he launched three years ago would last this long. GM hoped to boost sales in the wake of the September 11 terror attacks, grab some market share, then pull back on 0% deals and rebates. But since then, competition in North America

has heated up, GM's fleet has aged, and competitors have responded with their own aggressive rebates. As a result, GM's market share has fallen, and margins have suffered in the past year. That culminated in the third quarter, when GM missed earnings expectations by a surprising \$100 million and lost money in its core North American business. Says Wagoner: "We have to be more aggressive to address some chronic problems."

That's putting it mildly: Wagoner may need to take a hard look at his strategy. He's hoping cost cuts, and new cars due next year, will keep GM chugging along until a bevy of new, higher-profit trucks and SUVs arrive in 2006. But with European operations hemorrhaging and health-care costs soaring, GM may need more drastic action. Some analysts think it may even have to close plants in the U.S. to boost margins. "This company has too much capacity," says Stephen Girsky, an analyst at Morgan Stanley. "It's causing them to make bad long-term business decisions."



WAGONER His high-volume, deep-discount strategy is losing steam

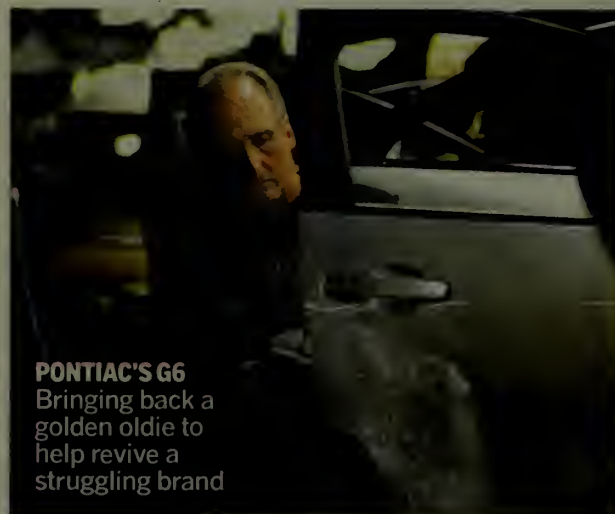
In fairness, there are no easy choices. Closing plants means wrestling with the union and possibly buying out workers, which can run into the tens of millions of dollars. As it is, GM likely will be shelling out truckloads of money to pay off workers as part of its plan to cut 12,000 jobs in Europe where the company has lost more than \$3 billion since 2000 (page 54). Also, Wagoner is loath to cut capacity and cede market share, since doing so would leave GM with lower revenues from which to pay health-care and pension costs that are expected to hit \$6.7 billion this year.

Clearly, he would rather keep fighting for market share and shave costs. The company has already targeted

\$600 million in cost cuts in North America this year by using vehicle platforms more efficiently and shelving a program to build a Hummer competitor to the Jeep Wrangler. Meanwhile, the company will launch several new models, including the Pontiac G6, in the hopes of reviving interest in its struggling car brands.

But the challenges are mounting. GM expects its health-care costs to rise next year. And while its retiree ranks—and therefore its pension and health-care costs—will begin to shrink in 2008, those costs will continue to be a big drag well into the next decade. Meantime, in mid-October, the Securities & Exchange Commission asked GM for information on how its health-care and pension-fund accounting affects earnings. Analysts say the scrutiny may nudge GM to be more conservative in how it estimates fund income, potentially yielding less for the bottom line.

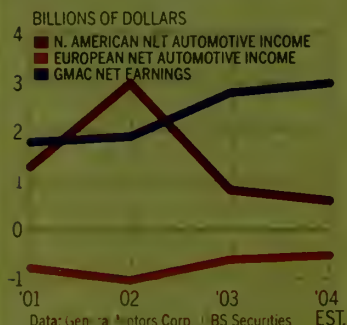
And it's not as though Wagoner can count on GM's finance arm, GMAC, to prop up the auto side forever. While GMAC is expected to earn more than \$2 billion in '04 and close to that next year, higher interest rates and a downgrade of GM's debt rating by Standard & Poor's could slow it. In the near term, S&P's Oct. 14 downgrade to BBB-, a step above junk, won't hurt GMAC earnings, say analysts. But it could in the long run. "If GM's profits don't improve, investors will assign a higher probability that the company's



PONTIAC'S G6
Bringing back a golden oldie to help revive a struggling brand

MIXED PICTURE

As GM's auto business falters at home and bleeds in Europe, only financing remains strong



ating will fall to junk," says Kris Grimm, Lehman Brothers Inc. corporate bond analyst. That would boost borrowing costs. S&P gave GM a stable outlook, so analysts don't think it risks hitting junk status before 2006. If it does, GMAC will find it harder getting cheap capital to make auto loans.

Add it all up, and Wagoner's margin of error is thin indeed. GM needs flawless execution on its new products to get consumers into its showrooms," says Girsky. If that doesn't happen, the auto maker may be forced to make the kind of cuts in

North America that it plans in Europe. If so, Wagoner has some options: GM will likely replace two underused Lansing (Mich.) plants that make the Chevrolet Malibu Classic and Pontiac Grand Am—which sell mainly to rental fleets—and replace them with one new SUV plant. The company also may shutter a van plant in Baltimore and an SUV plant in Linden, N.J., and could cancel shifts in other factories. None of these moves will come cheaply, but without some big wins in the market, Wagoner may have little choice. ■

AUTOS

How Hybrids Are Going Mainstream

When Toyota Motor President Fujio Cho predicted in June, 2001, that cumulative sales of the company's hybrid vehicles would hit 300,000 within four years, many industry watchers heard hype. After all, Toyota sold only 15,556 of its first-generation Prius hybrids in the U.S. that year. But Cho now looks prescient. After plowing hundreds of millions of dollars into developing these vehicles, which cut fuel use by mating an electric motor to a gas engine, hybrids have gotten traction. Prius sales in the U.S. alone are expected to hit 100,000 in 2005.

Now Toyota is shifting into Phase Two of its strategy: moving hybrid technology into the core of its lineup. Early next year, the auto maker plans to launch hybrid versions of its Highlander and the Lexus line of RX SUVs. Toyota also says it's considering a hybrid version of the Camry, America's best-selling car. Toyota isn't alone: Honda, which already sells a hybrid Civic, will roll out a hybrid Accord (page 114) in December.

With each model, the Japanese auto makers are trying to ensure buyers get a car that offers better fuel economy but doesn't skimp on power and comfort. Their goal: popularize the technology enough that they can scrape out the economies of scale needed to bring the cost of building hybrids—and thus their prices—more in line with conventional models. If Toyota and Honda succeed, not only will they find it easier to roll out hybrid



TOYOTA'S PRIUS Japanese makers are leading the way

versions across their product lines but they will also gain a big advantage on their Motown rivals as the industry finally moves away from gas-guzzling engines. "Detroit is a couple of generations behind the Japanese," says Rex Parker, an analyst at Tustin (Calif.)-based AutoPacific Inc. "And in this business that's a long, long time."

Given how new hybrid technology is, no one knows how fast it will reach critical mass. But the notion that hybrids are no more than a niche market for greens is fast fading. If gas prices stay high and the technology continues to improve, consultants Booz Allen Hamilton Inc. figure hybrids could grab up to 20% of the U.S. market by 2010. "There is no longer a

performance gap" with non-hybrids, says Bill Jackson, vice-president in charge of Booz Allen's automotive practice. "And with gas prices hovering north of \$2, the economics are starting to look pretty compelling."

For now, though, auto makers still have to convince drivers it's worth paying up to

\$3,400 extra for a hybrid. Honda and Toyota hope to lure them with both power and luxury. The Accord will sport the first six-cylinder hybrid engine, providing 15 more horses than the already peppy conventional Accord engine; yet fuel consumption in city driving, Honda claims, will improve by 43%. The sedan also will boast leather seats, side airbags, and an XM Satellite radio. Honda

expects to sell 20,000 hybrid Accords and 30,000 hybrid Civics next year. Down the road, it's considering building hybrid SUVs or light trucks, says Dan Bonawitz, Honda's vice-president of corporate planning for the U.S.

Toyota, meanwhile, is bringing hybrid technology to the midsize SUV. The company's Lexus

RX and seven-seater Toyota Highlander SUVs will feature 270-plus horsepower and better than 27.6 mpg—currently the average for a compact sedan. "The objective was to have a six-cylinder engine with all the power of a V-8," says Dave Hermance, a top Toyota environmental engineer. "It's for folks who want to do the right thing without making compromises."

While Detroit for the most part has sat out the hybrid revolution so far, Ford Motor Co. is moving toward a similar, mainstream strategy. It beat the Japanese to market with the first hybrid SUV, the Ford Escape, which was launched to loud applause in September. Still, it's several years behind its rivals in developing a strong array of models.

Ultimately, getting prices down is crucial. And the only way that will happen is if auto makers develop a technology sufficiently mainstream to be mass produced. To get there, Toyota has begun licensing its hybrid technology to rivals like Nissan Motor Co., which plans to launch a hybrid Altima in 2006. Toyota and Honda are betting their strengths in engineering and manufacturing will keep their newest hybrids well ahead of competitors. If past is prelude, that's a bet few would take.

—By Chester Dawson in Los Angeles

THE STAT

20%

Hybrids' projected share of the U.S. market by 2010.

Data: Booz Allen Hamilton Inc.

COMMENTARY

BY RICK DUNHAM

The Election: Watch These Indicators

How to cut through poll fatigue and gauge the candidates' real chances

CONFUSED BY conflicting polls? Worried that your favorite candidate for President has yet to put away his rival? Given the tightness of the election and the uncertainty over turnout, it's hard for even the most attentive voters to cut through the cacophony of spin, campaign blather, and last-minute scare tactics. With George W. Bush and John Kerry slogging

toward the finish line—while revving up the turnout machines that each hope will put them over the top—here are some leading indicators that could help campaign-weary voters gain a sense of how the battle for the Presidency is faring:

THE POLLS THAT REALLY COUNT Forget about all the horse-race polls at this point: They're too volatile. Three key survey questions "tell us more about the results than the day-to-day tracking polls," says Catholic University political scientist John Kenneth White. And they have been reliable predictors of incumbent reelection for the past two decades. The incumbent went down to defeat when less than half of the electorate approved of the President's job performance or felt he deserved another term. Likewise, if a majority of voters say the country is heading in the wrong direction, it has been curtains for the President.

By those standards, Bush is on the precipice at the moment. His job approval in the 10 most recent polls averages 49.5% and is below 50% in 6 of the 10. And the mood of the country has been sour since early February. In one typical survey, an Oct. 11-14 George Washington University 2004 Battleground Poll found that 41% of voters say the country is on the right track and 52% say it's off-track. That's one reason the Bush campaign has been trying to whip voters into a

patriotic frenzy in the closing weeks of the campaign.

WHAT'S IN A NUMBER? Government statistics can affect the psyche of the electorate, and two upcoming economic reports could be pivotal. On Oct. 22, the Bureau of Labor Statistics releases state employment data, and the focus is on two hotly contested states where manufacturing jobs have been disappearing during the Bush years: Ohio and Wisconsin. Bad job numbers would spell three successive months of rising unemployment in the Buckeye State—more grim news for Bush. But if jobs are on the mend, the President could get a late lift.

Better macroeconomic news is more likely on Oct. 29—four days before the election—when the Commerce Dept. releases third-quarter gross domestic product estimates. Economists are predicting solid gains, which could make voters feel more up-

beat about the future. However, if growth fails to meet expectations, Democrats will argue that the economy is slowing dangerously, putting job creation at risk.

Bush badly needs a change in consumer confidence. For the first time since May, more Americans feel the economy is getting worse than think it's improving. A major factor: record-high oil prices, now hovering around \$53 per barrel, have sent gasoline soaring back past \$2 per gallon. That phenomenon, together with predictions of double-digit hikes in heating-oil prices, sends a chill through Bush operatives in the northern battlegrounds. Republicans are hoping for at least a temporary respite in price hikes by Halloween.

DEMOGRAPHY IS DESTINY While most voting blocs are predictably pro-Bush or pro-Kerry, a few groups remain up for grabs. And how they move in the final week of the campaign could be crucial. For Kerry to win, he needs to come close to Al Gore's 11-

percentage-point advantage among women in 2000. But an Oct. 17-18 Fox News/Opinion Dynamics Poll gave Bush a 47%-to-43% edge among likely female voters. "Women have gone back and forth," says Andrew Kohut, director of the Pew Research Center for the People & the Press. "Swing voters are still unsettled." Kerry's challenge: to reverse recent declines among less educated women and suburban moms.

The youngest and oldest voters will also be key. Kerry has slipped among under-30 voters, from a 2-to-1 advantage earlier this year to a 50%-46% edge in the ABC News/*Washington Post* survey. Older voters, meanwhile, split 47%-47%. Any shift among seniors could tip the dead-even states of Florida and



Pay attention to jobs, consumer confidence, and women voters



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Iowa. No wonder Kerry has been aggressively accusing Bush of having secret plans to privatize Social Security and reinstitute the military draft—charges the White House dismisses as desperate flailing.

GET OUT YOUR VOTE One reason the polls are unreliable is that nobody knows how many people will actually vote. Democrats say the polls undercount their supporters because traditional survey techniques do not measure the intensity of anti-Bush feeling and the surge in new registrations. Indeed, some evidence indicates that the new wave of voters leans toward Kerry. An Oct. 14-15 *Newsweek* Poll found that first-time voters favored Kerry 57% to 36% and that people who had already voted early chose the Democrat, 52% to 43%.

Most political analysts say Democrats and their liberal allies did a more effective job registering voters. Their challenge is getting the newbies to the polls. And while most Democrats are united by antipathy for Bush, Republicans remain more charged up about their candidate. According to ABC, 59% of Bush partisans are strongly enthusiastic, compared with 45% of Kerry backers. Unless Democrats can better motivate their base, they could fall short.

WEIGHING THE INTANGIBLES Four years ago, Bush was thrown off stride in the final days of the campaign by revelations of a youthful drunken-driving arrest. Any seemingly innocuous fuss—such as the anti-Kerry blowback over his comments on the sexual orientation of Dick Cheney's daughter—could alter the equation this year as well.

Democrats are hoping to get mileage out of the flu-vaccine debacle, but it's not clear whether voters will blame the President for the failure of public health officials to develop backup plans. Then there is the possibility of big news from the war zone, which could range from a bloody insurgent attack to the triumphant capture of Osama bin Laden or Abu Musab al-Zarkawi. And, unfortunately, the ultimate wild card looms: an election-eve terrorist attack in the U.S.

Which factor will matter most in the end? If al Qaeda strikes, all bets are off. Otherwise, insiders figure that turnout will decide which candidate wins on Nov. 2. Both sides know they must do all they can to get their core loyalists to the polls in sufficient numbers to eclipse their shortcomings elsewhere. That's why an already harsh campaign season will get even uglier as Bush and Kerry duke it out until the bitter end. ■

HOUSING

HOMEBUILDERS ARE STRETCHED THIN

Even as demand falls, they're taking on debt to keep up their pace

TO THE CASUAL OBSERVER, the homebuilding industry appears to be in remarkably good shape this deep into the housing cycle: Most of the large publicly traded builders such as Lennar Corp. and KB Home are still reporting double-digit gains in both sales and profits. And most also still boast high returns on their investments. Los Angeles-based KB Home, for instance, is on a pace to earn 16% return on capital over the past year. "Other companies only dream about that," says KB Chief Financial Officer Dom Cecere.

Yet despite those solid numbers, cracks are starting to form in the foundations of the nation's largest homebuilders. To maintain their heady growth rates, the big builders are placing ever-bigger bets as they continue adding to their land holdings and the number of houses they have under construction. Even as the Federal Reserve has started raising interest rates—while signaling that further hikes lie ahead—builders have continued to throw up new homes at a furious pace. The amount of capital that the 14 largest publicly traded builders have tied up in inventories of unsold homes and land, adjusted for sales, has risen an average 12% over the past year, according to Palladian Research LLC, a New York institutional research firm.

As a result, those inventories now stand at the highest level relative to sales in seven years. And some builders are faring much worse than average. Inventories at Dominion Home Inc. in Dublin, Ohio, for instance, have soared 38.8%, while Ryland Group Inc. in Cal-

abasas, Calif., has seen them jump 30.6%. "They are increasingly running their businesses with an 'If we build it, they will come' mindset," says James D. Poyner, a market strategist at Palladian.

BORROWING FRENZY

TO FUND ALL this new construction, homebuilders are burning through cash at a furious pace. For the 12 months ended in June, the large publicly traded builders laid out \$373 million more cash than they took in, Poyner notes. Compare that with the much more modest \$73 million "burn rate" builders went through for the year that ended in June, 2003. That has left builders increasingly resorting to debt and stock issuance to fund their operations: Of the 14 largest publicly traded builders, six now have debt-to-equity ratios of 95% or higher, including Dominion and KB Home.

What concerns critics is that this frenzy of borrowing comes as housing demand is starting to cool. Single-family starts dipped 8.2% in September to a seasonally adjusted annual rate of 1.54 million units. Some Wall Street experts, such as Jan Hatzius, senior economist at Goldman, Sachs & Co., predict that single-family starts could slide an additional 10% to 20% in the coming year as higher rates take their bite. "The risks of a serious problem will rise the longer

Six of the 14 largest have debt-to-equity ratios of 95%

CALIFORNIA
Pulte Homes
has cut its
prices 8%
to 20%

construction activity remains at its current elevated level," Hatzius wrote in an Oct. 15 report.

Builders counter that fears of a housing crash are overblown. They argue that their land purchases are largely in the form of options that often require them to put down less than 10% of the value of the tracts; even then, they say they often build only when firm orders from buyers exist. What's more, builders contend that if demand cools, they'll have the wherewithal to scale back construction quickly—and turn negative cash flows back into positive

territory by simply selling down their existing inventory of finished homes. "When the market does slow down—and our data doesn't show that it is slowing down—our earnings might slow, but free cash flow will come in bucketloads at that point," says J. Larry Sorsby, chief financial officer for Hovnanian Enterprises Inc., a Red Bank (N.J.) builder.

Still, there's growing evidence that cooling demand already has some builders coming up with novel ways to produce higher profits. To generate a 12% rise in earnings during its third quarter—less than half the growth rate of recent quarters—Miami-based Lennar resorted to heavy land sales to other builders. Kathy Shanley, a senior analyst for Gimme Credit, a bond-research firm, estimates that in the quarter that ended on Aug. 31, Lennar generated roughly a quarter of its \$225 million in earnings from land sales to other builders. Moreover, with gross margins of 37%—well above the 22.9% gross margin Lennar generates from its home sales—such sales also help keep overall margins up. By contrast, land sales contributed less than \$2 million to

Lennar's bottom line as recently as 2001 and 2002. The company's chief financial officer, Bruce E. Gross, says the land sales occurred only because it saw opportunities to exploit heavy demand for new tracts by

other builders. "We're not liquidating our assets to meet a number," he insists.

Maybe not. But Lennar clearly needs land sales to counter weak orders in some markets and to boost profits. In its West Coast markets, new orders fell 6% in its fiscal third quarter. Another potential sign of weakening market conditions: Fully 35% of Lennar buyers took out adjustable-rate mortgages, vs. just 20% a year ago. That suggests that some customers "are straining to afford current price levels, even with low interest rates," says Shanley. Gross says the rising use of adjustable-rate mortgages simply reflects buyers' growing preference for lower-cost, floating rates. "We haven't seen any degradation in credit quality," he says.

CANCELLED ORDERS

IN MARKETS THAT HAVE gotten overheated, some builders are starting to get burned. In Las Vegas, home prices rose an average 41% over the last year, fueled in part by speculators flipping new homes almost as soon as they're finished. With the rise in interest rates, however, the Vegas bubble has burst. Inventories of unsold existing single-family homes in Las Vegas shot up from 1,400 in February to more than 15,000 in September.

That's one reason Pulte Homes Inc. in Bloomfield Hills, Mich., announced in early October that its 2004 profits will come in as much as \$50 million below expectations. After raising prices in some developments by over 50% over the past year, Pulte is rolling them back 8% to 28%. Still, buyers continue to cancel orders in droves. Some analysts say cancellation rates are running at about 25% throughout Las Vegas. "We overpriced our product relative to the competition," says Pulte Chief Executive Officer Richard J. Dugas Jr. But even with lower prices, Dugas maintains that Vegas remains "among the company's leading markets for margins."

Given the heavy bets builders have placed, a slowdown doesn't auger well. All of a sudden, the housing industry's future is looking more and more like a roll of the dice. ■

—By Dean Foust in Atlanta and David Henry in New York, with Christopher Palmeri in Los Angeles

RED FLAG FOR HOUSING?





PHARMACEUTICALS

ANTEGREN: HYPE OR HYPERDRUG?

Biogen's much-ballyhooed MS fighter is getting positive signals from the FDA

MULTIPLE SCLEROSIS sufferers have not benefited from a new type of drug for more than a decade. That may change by Nov. 26, when the Food & Drug Administration is expected to decide whether to approve Antegren, a dramatically different treatment for the chronic disease. The drug was co-developed by Biogen Idec Inc. of Cambridge, Mass., and Ireland's Elan Pharmaceuticals Inc.

Expectations are running high for Antegren, particularly on Wall St. Biogen Idec's stock is up 57% since January, to about \$57 in mid-October, while Elan has soared from \$5 to \$24. Although most of the gains came early in the year, glowing analysts' reports in recent weeks have also fueled rumors that Biogen might buy its partner. Morgan Stanley sees annual sales surpassing \$2 billion by 2008, while market researchers Decision Resources Inc. says Antegren "will radically alter the multiple sclerosis market."

Will Antegren live up to the hype?

Plenty of biotech drugs have generated outside expectations only to fizzle. And Antegren faces challenges, not least whether insurers will pay the drug's projected \$20,000 annual cost, nearly double that of current treatments.

What's more, doctors don't know if the drug works better than existing treatments. In an unusual move, Biogen and Elan decided not to release data from two large clinical trials until after the FDA rules. Although the drug did show promising results in a mid-stage trial, that study lasted only six months and involved a small number of patients. "We don't know anything about the long-term safety of the drug, or how it compares with existing therapies," cautions Stephen C. Reingold, research head of the National Multiple Sclerosis Society.

The FDA has sent positive signals,

ADELMAN So far, Biogen's research head says, the FDA likes what it sees

though, granting Antegren a rapid review last May after looking at one year results from

the Phase III clinical trials, designed to run two years. Biogen says it wants to hold off releasing that interim data so as not to prejudice the final outcomes of the trials, due to end early next year. But Dr. Burt A. Adelman, head of research and development for Biogen, says the FDA typically doesn't like to base approvals on interim data. "They said these results were very striking."

MISSING EVIDENCE

ANTEGREN ALSO seems promising because it is the first drug designed to block the out-of-control immune cells that cause MS. These cells attack the coating that surrounds and protects nerve fibers. Over time, nerve cells are destroyed, and patients experience symptoms ranging from fatigue and blurred vision to poor muscle control and speech impairment. A patient can go weeks, months, or years without a relapse, but about 50% of sufferers end up progressing to permanent disability.

The most common treatments, led by Biogen's own Avonex, are based on interferon, an inflammation-fighting protein. A patient self-injects with a needle daily or weekly. The interferons fight inflammation and reduce relapses, but they haven't been very effective in delaying progression

of the disease, and they can cause debilitating flu-like symptoms. By contrast, Antegren, a targeted antibody that blocks immune cells from reaching the nerve fibers, appears to have few serious side effects. It is given intravenously just once a month. Data from the mid-stage trial indicate that Antegren reduces inflammation and relapse better than interferon.

But so far no evidence exists that Antegren can

slow the progression of MS. That's what doctors want, says Dr. John R. Richert, head of the immunology department at Georgetown University Medical Center in Washington: "The most important information is whether it [delays] disability progression. If it doesn't, I don't really care what it does to [inflammation] or the relapse rate." Given the side effects of interferon, however, patients may beg to differ. ■

—By Catherine Arnst in New York

THE STAT

**\$2
BILLION**

Projected Antegren sales by 2008, 30% of the multiple sclerosis drug market

Data: Morgan Stanley

A photograph of two Arsenal fans jumping over a goalpost against a clear blue sky. The fan on the left is wearing a white and black Arsenal kit, while the fan on the right is wearing a red Arsenal kit. They are both holding a large Arsenal flag with a red and white checkered border and the Arsenal crest in the center. The goalpost is visible in the foreground, and the background is a solid blue sky.

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News In Biz This Week

EDITED BY MONICA GAGNIER

HEADLINER

AYLWIN LEWIS



HAD HIS FILL OF FAST FOOD

Seeking a leader for the next leg of its turnaround, **Kmart** on Oct. 18 named restaurant industry veteran Aylwin Lewis, 50, as chief executive. Lewis, a marketing expert, replaces Julian Day, whose finance skills helped guide the company through bankruptcy. Since January, 2003, Lewis had been president and chief operating officer at **Yum! Brands**, which runs KFC, Taco Bell, Pizza Hut, and other restaurants. At Yum, he was credited with expanding multibrand outlets and fostering teamwork. Edward Lampert, Kmart's controlling shareholder and chairman, said Lewis' brand expertise will help better position Kmart against No. 1 **Wal-Mart Stores** and No. 2 **Target**. "He will be able to define and communicate what Kmart stands for," Lampert says.

Since Kmart emerged from bankruptcy in 2003, it has returned to profitability. But it has yet to reverse falling sales. Analysts expect Lewis to capitalize on Kmart's strong presence in urban markets. Pulling that off could be far more difficult than selling pizza.

—Robert Berner

MOTOROLA: IN THE MONEY

Motorola's hot streak continued, with its third consecutive quarter of impressive earnings on Oct. 19. The communications giant said net income quadrupled in the third quarter to \$479 million, up from \$116 million last year. Motorola has aggressively cut costs, in stark contrast to rival **Nokia**, which is seeing profits shrink. Higher selling prices at Motorola's flagship cell-phone unit translated into a 26% hike in revenues vs. Nokia's 1% rise. But volume hasn't kept pace, so Motorola's 16% market share in phones isn't growing. Worse, investors frowned on Motorola's forecast of \$9.3 billion to \$9.6 billion in sales for the fourth quarter, sending its shares down 8%, to \$17.09, on Oct. 20.

3M'S STICKY SITUATION



3M Chief Executive W. James McNerney Jr.'s worries about whether global demand will remain strong, combined with third-quarter earnings per share that fell a penny short of expectations, weighed on 3M's stock. After 3M released results on Oct. 18 and McNerney expressed caution about the world economy, shares dropped 3.3% over two days, falling

below \$76. With more than half its sales coming from overseas, the maker of films and components used in computers, cell phones, and other gear is vulnerable to any hiccup in global demand. 3M reported a 17% rise in quarterly profits, to \$775 million, on a 7.6% gain in sales, to \$4.97 billion.

THE SEC PRIES INTO PENSIONS

The auto and airline industries have been targeted by a Securities & Exchange Commission investigation of accounting for pension and retiree medical plans. **General Motors**, **Ford Motor**, auto-parts maker **Delphi**, and **Northwest Airlines** have disclosed requests from the SEC for documents, including e-mails, relating to estimates the companies used to calculate pension expenses and obligations. As first reported in *BusinessWeek* (BW—Oct. 25), the SEC wants to see whether corporate managers tinkered with assumptions, including the expected rate of return, to enhance earnings and balance-sheet numbers. The SEC has not found evidence of wrongdoing by any of the companies it contacted.

WHILE THE CITI SWEEPS

Heads are rolling at **Citigroup**. A month after Japanese authorities shut down the Citi's private banking operations for lax money-laundering controls, CEO Charles Prince III has cleaned house. On Oct. 19, three of his top lieutenants resigned—including Deryck Maughan, chairman of Citigroup International, who is credited with achieving a 30% gain in international

earnings last year. Prince also pushed out Thomas Jones, head of the bank's asset-management business, and Peter Scaturro, head of Citigroup Private Bank. The three resigned after an independent probe by former U.S. bank regulator Eugene Ludwig. The trio could not be reached for comment. Citi declined to discuss the departures.

ET CETERA...

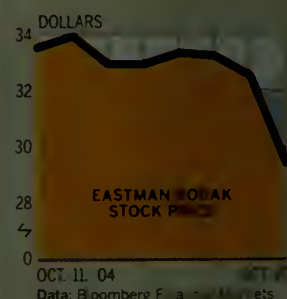
» **J. P. Morgan Chase's** quarterly profit fell 13% after its **Bank One** purchase.

» **IBM's** quarterly revenues gained 9%, as profits rose 12%, excluding special items.

» **eBay** reported a 77% gain in quarterly profit.

CLOSING BELL

Shares of **Eastman Kodak**, which have had a fine run, fell 9% on Oct. 20, to \$29.60. The culprit: third-quarter revenue growth of just 1%. Even a 39% surge in digital products couldn't offset a 13% decline in Kodak's much larger traditional film-based business.



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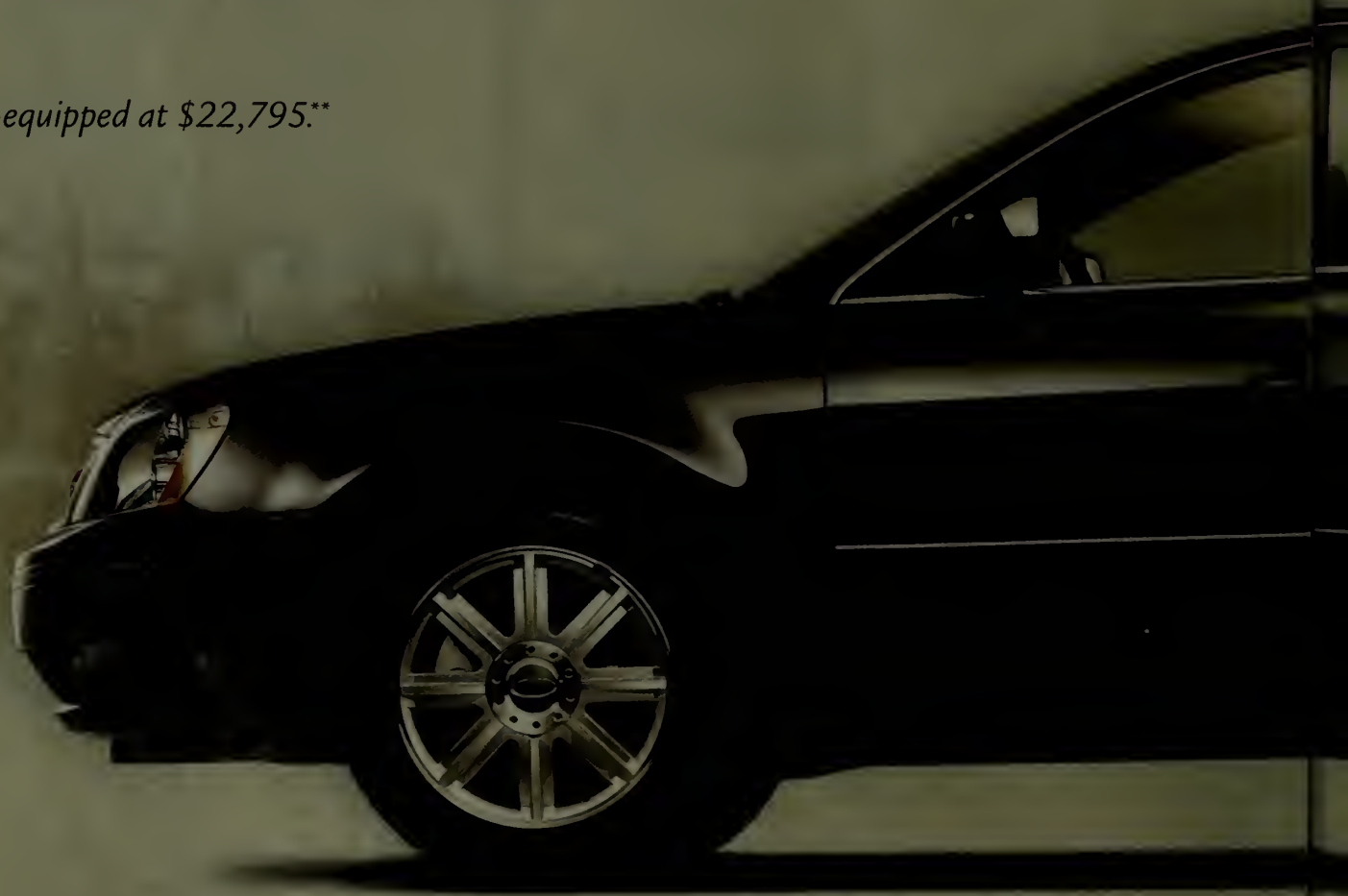
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—Kiplinger's, May 2004

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BY RICHARD S. DUNHAM

Congress 2004: Who Won, Who Lost

CONGRESS COULDN'T GET out of town fast enough. After throwing billions of dollars at business lobbyists in a last-minute spree, lawmakers hit the campaign trail for their final election push. Back in the deserted capital, power brokers were trying to assess who hit pay dirt and who fell short in a city tied up in partisan

notes. Indeed, the bitter 108th Congress produced few winners and lots of losers. Here's the score from *BusinessWeek's* Washington bureau:

Winners

U.S. manufacturers and their foreign affiliates were in hog heaven after passage of the pork-laden \$136 billion corporate tax relief package on Oct. 12. The new bill effectively lowers the rate on domestic manufacturing profits by 3 percentage points, allows small businesses to expense up to \$100,000, and permits U.S.-based transnationals to repatriate profits at a 5.25% tax rate instead of the normal 35% rate.

Securities & Exchange Commission chairman **William H. Donaldson** showed a left political touch yet again. The Wall Street veteran fended off lawmakers' attempts to tighten mutual-fund rules by convincing them the agency could do the job itself. Despite rumbling, Congress also has not thwarted SEC plans to tighten oversight of hedge funds by requiring fund managers to register with the agency.

The **NRA** again proved why it's the top lobby shop in town. Congress let the assault weapon ban lapse despite strong support for the law from suburban swing voters. Now the NRA is spending millions to mobilize hunters to vote for President Bush.

After winning a long fight to ban late-term abortions, the **Religious Right** secured passage of a law that makes assaulting a pregnant woman a double crime—for harming her and her fetus. If it survives

court challenges, the law would be a major step in giving fetuses constitutional rights.

Losers

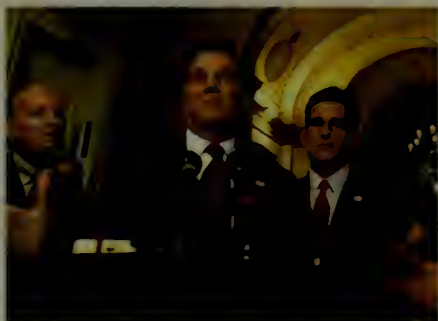
The Republicans' Medicare reform law was a major flop. Only about 10% of seniors ever signed up for the **Medicare drug card**—and the majority of them were automatically enrolled through their Medicare HMOs or state low-income programs. Seniors were confused by the card options or found better deals through existing discount programs. Not surprisingly, John Kerry has a 54% to 41% lead over Bush on Medicare, according to an Oct. 14-16 Gallup poll.

Silicon Valley failed to win approval of either of its two 2004 priorities: federal subsidies for broadband and a bill that would stop the expensing of stock options. But it will try again on expensing in a postelection, lame-duck session.

The big corporate loser: **Boeing**, which blew a sweet Pentagon deal. The 2005 defense authorization

bill bars the Air Force from leasing 100 Boeing 767s for use as tankers. The ban was the penalty for a scandal in which a top Air Force official worked on the deal while negotiating with Boeing for a lucrative job.

House Majority Leader **Tom DeLay**, known for his iron-fist control over GOP lawmakers, earned back-to-back rebukes from the House ethics committee. The prodigious fund-raiser was admonished for creating the appearance that he was trading legislative favors for donations. But since the gerrymandering plan DeLay engineered in Texas could keep Republicans in power for the next two years, his leadership position appears safe. For now. ■



DOUBLE DOSE
DeLay got two
wrist slaps in
a week

CAPITAL WRAPUP

'04 POLITICAL FASHION: COATTAILS ARE SHORT

George Bush and John Kerry are so focused on their own election that they're offering little help to down-ballot candidates. Representative **Thomas M. Reynolds** (R-N.Y.), chairman of the National Republican Congressional Committee, says he has "no anticipation of coattails" in 2004 House contests. Case in point: Despite Bush's 11-point lead in a heavily GOP central Pennsylvania district, incumbent Democrat **Tim Holden** leads highly touted Republican **Scott Paterno**, son of the legendary Penn State football coach, 48%-36%, according to an Oct. 14-15 American Research Group poll. Indeed, says Reynolds, Presidential popularity has not affected congressional races, "even in Texas where I've seen the President as high as 70-some percent." Five Dem incumbents there are in jeopardy due to a GOP redistricting plan. Likewise, Democrats still face uphill fights in Bush-phobic districts in Connecticut, New York, New Jersey, and Pennsylvania.

BIRDS OF A POLITICAL FEATHER...

YOU CAN'T choose your family, but you can choose your friends. Still, Americans tend to share the partisan affiliation of both relatives and buddies. An Oct. 12 **Harris Poll** found only 15% of Republicans come from Democratic families and just 12% of Democrats have Republican relatives. People are even more likely to hang out with others who share their political views: Just 10% of Dems say that most of their friends are Republicans. And a mere 14% of GOPers break bread most often with Dems.

GERMANY

SHOWDOWN IN THE RUHR VALLEY

A new wave of layoffs looms in Germany's industrial heartland, and unions are mobilizing for battle

DEEP IN THE HEART OF Germany's Ruhr Valley, a column of 25,000 angry blue-collar workers and their families has taken to the streets of Bochum, waving banners and red union flags, beating drums and blowing whistles. This scene has been replayed often in the past four decades as one wave of jobs after another has left the Ruhr, Germany's industrial heartland. This time, unions and workers are venting their anger against a massive restructuring announced by General Motors Corp. on Oct. 14 that will slash the company's workforce by 12,000 in Europe, including an estimated 4,000 jobs in Bochum alone. "This is a tragedy for the entire region," says Horst Krüger, a stocky, 46-year Adam Opel worker from Bochum. "We had coal, and then the mines closed. Opel came and gave people jobs. Now I don't see how we'll be able to replace the 4,000 jobs Opel wants to cut."

You want to find the dead center of the crisis gripping German industry? Go to the Ruhr Valley. The coal mines and hot metal furnaces that transformed the region into Europe's industrial engine a century ago have long since shut down, destroying 500,000 jobs. To revitalize the Ruhr, state and local governments have invested in research and education, transformed abandoned steelworks into industrial parks, and seeded new start-

ups. But despite two decades of redevelopment effort, unemployment across the valley's main cities remains stubbornly high at 12% to 19%, well above the national average of 10%. And growth remains chronically weaker than in other regions of west Germany.

SWEET DEAL

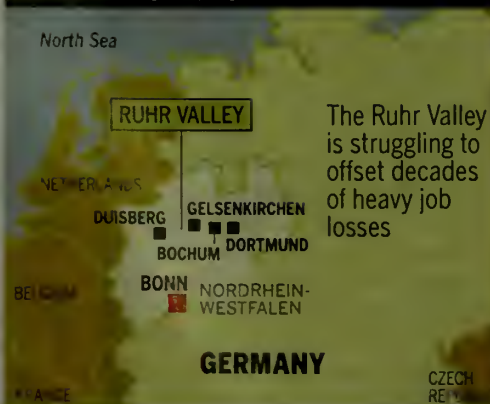
NOW, AS ANOTHER WAVE of wrenching layoffs looms, the struggling Ruhr is again becoming a pivotal battleground between the unions intent on preserving decades of generous pay gains and shorter working hours and corporations increasingly desperate to save themselves. One root problem is an anachronistic system of industry-wide wage agreements that has led to spiraling labor costs, pricing German industry out of the global market. Like the rest of their German brethren, the factory hands at the Opel factory in Bochum work only 35 hours a week and earn wages of \$41 an hour—compared with \$38 an hour in France. "In Germany we have the highest wages in the world in the car industry," says Fer-

dinand Dudenhoeffer, director of the Center for Automotive Research in Gelsenkirchen, a heartland Ruhr city once dominated by the coal industry. "If wage costs don't come down, 'the risk for the German economy is huge,'" he adds.

German auto makers already have plowed billions into new factories in eastern Europe, where labor costs are lower. But until now, German unions and workers remained confident that even as new capacity flowed east, jobs at home would remain safe. GM's sweeping restructuring of its European operations, which have racked up \$3 billion in losses in the last four years, has suddenly made it clear that Germany faces another epochal loss of manufacturing jobs if unions remain intransigent. While Opel workers voted on Oct. 20 to return to work after a surprising wildcat strike, the closure of the Bochum plant—GM's least efficient in Europe—has not been ruled out. German auto suppliers already have shifted some 100,000 jobs to eastern Europe and Turkey over the past 10 years—and 40% of all suppliers plan to transfer additional production abroad.

GM's crisis in Europe and a looming labor face-off at Volkswagen in November may weaken force long-overdue change on Germany's inflexible labor model, which works to preserve the status quo while ignoring global forces that can flatten entire industries. That model delayed a much needed restructuring of the economy of the Ruhr. In the 1980s, a coal and steel came ur-

VALLEY OF WOE



■ **BOCHUM:** GM aims to cut at least 4,000 jobs at its factory

■ **DUISBURG:** ThyssenKrupp shuttered a huge steelworks in 1993, throwing 20,000 people out of work

■ **GELSENKIRCHEN:** Some 3,000 jobs were lost in 2000 when the last coal mine in this former mining center closed

■ **DORTMUND:** Unemployment is at 14.8% despite investments in high-tech startups



ANGRY Opel
may cut 4,000
jobs in Bochum

ergy, e-logistics, and environmental technology. Bochum's growing talent pool drew Finnish mobile phone maker Nokia to locate its only German factory nearby, creating 2,300 jobs.

HIGH TECH, FEW JOBS

BUT EVEN OPTIMISTS recognize it will take 10 to 20 years for the area's new-technology-driven industries to boost employment. Even then, tech companies can't ease unemployment among old-line industrial workers. Siloxa Engineering, a thriving Essen environmental technology company, exports to Japan, France, and elsewhere. But the six-year-old outfit only employs 12 people; sales, though growing, are just \$2.2 million. Its engineers earn \$2,800 a month, well below what a factory worker at Opel Bochum makes. At least these small companies understand the reality of the global marketplace. Siloxa founder and Chairman Wolfgang Doczyck voices disbelief that unions, politicians, and employers are still clinging to an uncompetitive model for negotiating wages and working conditions. "There is no chance to salvage the old system," he says. "One big company after another will leave Germany."

No question, companies like Siloxa are a healthy sign that Germany is looking toward the future rather than the past. But the real test will be whether Opel's unions face up to Germany's eroding competitiveness and roll back wages while boosting working hours—or put their own future at risk by defending the world's most

pampered working conditions. For now, the Opel workers have a potent symbol of their defiance. As the protesters shout their disapproval of restructuring, a truck rolls slowly before them, carrying two workers ringing the local union's *Kampfglocke*, literally the "fight bell," a massive church bell suspended above the truck on a crane.

It's supposed to be summoning the workers to the struggle. It may be sounding the end of an era. ■

—By Gail Edmondson in Frankfurt, with William Boston in Bochum

GM is in no mood to back off: It threatens to shut Bochum for good

boasts five universities and seven advanced schools of applied sciences. In addition, 13 cutting-edge research institutes have sprung up in the Ruhr since the early 1990s, including Fraunhofer and Max-Planck, thanks to \$110 million a year in federal and state funding.

State and local governments also are channeling funds into cleaning up the smokestack industry graveyards and seeding new technology parks with startups in fields such as medical technology, computer services, biotech, renewable en-

er competitive pressure, the valley's unions, employers, and politicians banded together to protect jobs, pumping \$125 billion into coal subsidies since 1980. The center-left government of Chancellor Gerhard Schröder has earmarked \$2.8 billion for coal subsidies in 2004. "If those billions had been deployed in another fashion, we might have turned the Ruhr Valley into Silicon Valley by now," says Hans-Dietrich Winkhaus, president of the Institute of German Economics in Cologne and former chief executive officer of chemical giant Henkel.

One of the things Germany has done right in the Ruhr is to invest heavily in higher education and research. Until 1965 the Ruhr had no universities. Now it



JAPAN

THE GAIJIN GIVE JAPAN A WORKOUT

After more than a decade, outsiders have jump-started the cleanup of bad loans

WHEN JACK RODMAN first began visiting Tokyo in the early 1990s, he saw it as a gold mine for restructuring and buyout deals. After all, Japan's big banks were saddled with trillions of yen in bad loans to real estate speculators and industrial clients. Someone had to wade into this mess and force the debtors to cough something up.

Rodman, head of Ernst & Young's Asia Pacific Financial Solutions group and a veteran of the U.S. savings-and-loan debacle, was able and willing. Yet Japan's first sale of nonperforming loans didn't take place until 1997. After an initial burst, they came in only a slow trickle. "No one was willing to accept that there was even a problem," says Rodman.

Today the Japanese are welcoming workout honchos like Rodman with open arms. The bulge-bracket investment banks and U.S.-based private equity firms are buying record amounts of distressed assets in Japan. According to Ernst &

Young, so far this year foreign investors have spent \$14 billion on nonperforming Japanese assets, up from \$7.3 billion in 2003. "Last year was our biggest year ever, but right now is the peak," says Chol-Ho Kim, an executive vice-president at GMAC Commercial Holding Asia in Tokyo, a branch of General Motors Corp., which has invested more than \$1 billion in Japan's nonperforming loans since 1997. Considering that the workout firms pay a fraction of face value for these distressed assets, foreigners have acquired debts with a paper value approaching \$100 billion in the past two years—a major portion of Japan's total bad debt.

The creation of the debt workout industry in Japan is partly the handiwork of Prime Minister Junichiro Koizumi. He decided last year that Japanese

E&Y'S RODMAN The Japanese are finally listening to workout honchos like him

banks had to cut their nonperforming-loan ratios to 4.1% of assets by March, 2005

while his Financial Services Minister Heizo Takenaka, threatened to prevent banks from boosting their capital base with deferred tax assets unless they stepped up the pace. "After Takenaka took the bull by the horns, it opened up a wave of transactions," says Rodman.

TAKING EQUITY STAKES

NOW THE BANKS are even unloading the better-quality problem loans. When the first deals were hatched in the late 1990s, the only loans the banks were willing to shed were for real estate deals where the borrowers had stopped making payments. Today assets sold include the debt of companies still servicing at least some of their debts. Instead of flipping loans immediately, investors are acquiring equity stakes and taking an active management role to coax out more value, according to Clark Graninger, head of institutional banking at Shinsei Bank Ltd.

GMAC, for example, bought both the bad loans and an equity stake in a Nagoya-based real estate company six months ago. The company, which it refuses to name, got overextended in the early 1990s and has struggled with debt ever since. Once it got in the door, GMAC immediately began selling off noncore assets. The plan is to prepare it for resale within two years.

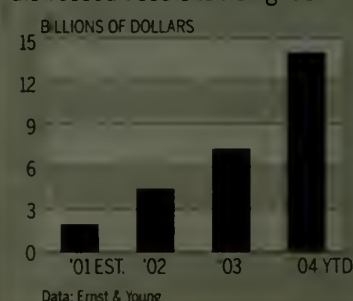
Other foreign firms are doing likewise. Goldman Sachs Group Inc. now owns two bankrupt golf course operators. Colony Capital, another U.S.-based private equity investor, struck a \$680 million deal in March for the debt-mired Sea Hawk Hotel & Resort and an adjacent professional baseball stadium in Fukuoka. Workout specialists expect a feast from the near-collapse of retailer Daiei

Inc., taken over on Oct. 13 by a state agency, the Industrial Revitalization Corp. of Japan. Analysts say the typical return on restructured assets that have been sold is 20% to 30% a year. "The [nonperforming loans] market has really picked up in Japan," says GMAC's Kim. About time. ■

—By Ian Rowley in Tokyo

BUYING DUD DEBT

Investment by foreigners in Japan's distressed assets is rising fast



BY JOSEY PULIYENTHURUTHEL

Bangalore: Tech Eden No More

India's IT center has exploded—and so have its infrastructure problems

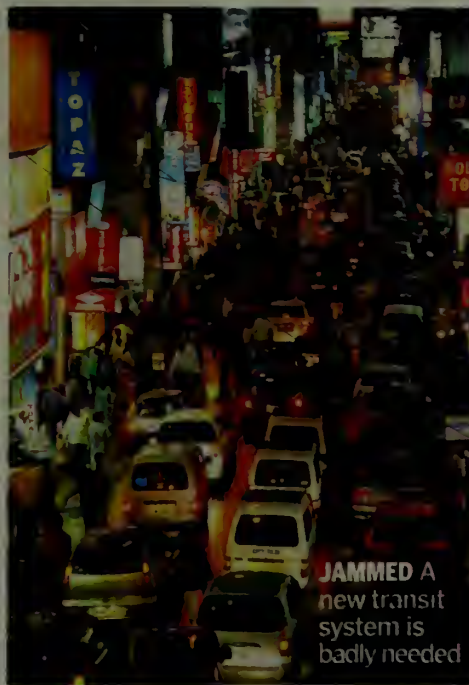
RAJISH NAMBIAR, a 20-year resident of Bangalore, is steamed. The managing director of Southern Chips & Circuits Ltd., an electronics-assembly firm on the city's outskirts, spends an hour in heavy morning traffic getting to his factory, just four miles from home. A year and a half ago it took him 20 minutes. The commute back is worse: He can get

stuck for as long as 90 minutes. "No Bangalorean deserves such a life," he fumes, arriving a half-hour late for an interview.

India's fast-growth high-tech industry has to worry about many things: high staff turnover; competition from China; and backlash from U.S. voters. But maybe what India should be focusing on is potholes and narrow roads. The fact is, Bangalore's growth explosion could cause the city serious trouble.

Execs like Nambiar would certainly agree. Just a year ago, Bangalore enjoyed a reputation not only as India's Silicon Valley but also as a pleasant, tranquil place to live, with a salubrious climate and tree-lined streets. But high-tech's Eden has proved a powerful lure. More than 1,300 software and outsourcing companies—450 of them multinationals—have set up sprawling campuses, employing 170,000 workers. The influx, which has helped increase Bangalore's population by a third since 1995, to 6.5 million, has resulted in choked roads, power outages, erratic water supply, and poor sanitation. A \$1.1 billion metro system, long seen as a solution to Bangalore's transport headaches, is far behind schedule. Industry worries that a long-overdue new airport, due to begin operations in 2010, may also be delayed. "The city is collapsing," says Bob Hoekstra, chief executive of the Philips Software Center.

The crowded roads mean tech workers arrive at work spent and frustrated, and they're less productive. Industry insiders say some companies have begun to build more man-days into project budgets because of commuter crawl. Others are looking elsewhere. Wipro Ltd. and rival Infosys Technologies Ltd., two of the city's largest employers, are setting up operations in Madras and even in communist-run Calcutta, both of which are keen to welcome Bangalore's deserters. "We will grow at a faster rate outside Bangalore," Wipro Chairman Azim H. Premji told reporters on Oct. 15.



Choked roads, poor sanitation, pollution, and an iffy water supply

Companies and citizen groups blame a nonresponsive Karnataka state government for Bangalore's worries. Within weeks after a new coalition state government took office in May, work on urban development projects—\$40 million worth of roads and overpasses, and a sewage works—ground to a near-halt. That's partly because the Congress Party-led government in the

state has rushed to fulfill promises to make improvements in rural areas and neglected the cities.

Tech companies have petitioned new state Chief Minister Dharam Singh for change. "There is zero focus, no hand at the wheel," says Infosys Chief Executive Nandan M. Nilekani. Upset, 15 top tech outfits, led by Royal Philips Electronics and Hewlett-Packard, plan to boycott state-led events such as the prestigious BangaloreIT.com tech conference, held annually in November to highlight the city's prowess. A road blockade planned for Oct. 15 by the tech execs was canceled after pleas by officials wary of bad press in a week when

Google Inc. founders Sergey Brin and Larry Page were visiting.

The state government denies any anti-Bangalore bias. M.K. Shankarling Gowda, the senior bureaucrat in the state's information-technology department, thinks the troubles "affect only pockets" in south Bangalore. Congestion, he says, will soon be eased when work begins on various road and other transportation projects. But business leaders are skeptical. The alarm bells have not started ringing as yet, says Sunil Mehta, vice-president of Nasscom, India's IT trade group, but the chaos in Bangalore could soon have "an adverse impact on the local economy." Given that the city contributes a third of the country's software exports, a crisis in Bangalore could turn into a traffic jam India can do without. ■

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EDITED BY ROSE BRADY

Mexico: Will the PRI Be Top Dog Again?

POSTAL WORKER PATRICIA HERRERA LOPEZ was one of millions of Mexicans who voted in 2000 to elect President Vicente Fox, whose National Action Party (PAN) promised dramatic political and economic change after seven decades of rule by the corruption-plagued Institutional Revolutionary Party (PRI). But she

says she'll vote for the PRI next time. "Under the PRI we lived much better. I was able to buy a house and get a car loan," says the 56-year-old grandmother. Today several family members are jobless, and government services have deteriorated. "I would have kept voting for the PAN if I had seen positive change, but I just don't see it."

Four years ago the PRI was thrown into turmoil by its defeat. Its leaders struggled to function in the opposition but were crippled by a \$92 million fine for campaign financing violations that forced them to lay off two-thirds of the party's staff workers. In Congress, the PRI adopted a spoiler strategy, joining with the left-leaning Party of the Democratic Revolution (PRD) to block legislation, including Fox's tax, energy, and labor reforms.

Voting with the PAN

TODAY THE PRI is back in fighting form. Since July the party has won four gubernatorial elections and the key mayoral vote in Tijuana. Now, PRI President Roberto Madrazo and his congressional leaders are working to shed their obstructionist image. They're voting with the PAN for bills that would ease fiscal pressures on the party that wins the 2006 presidential elections. "Madrazo is interested in having the ship in good shape if the PRI wins the election," says political scientist Federico Estévez of the Autonomous Technological Institute of Mexico. Even former president Carlos Salinas, though deeply unpopular, is working behind the scenes to bring the PRI back.

A PRI return to power is no longer incon-

ceivable. While charismatic Mexico City Mayor Andrés Manuel López Obrador of the PRD is the most popular presidential candidate, two of his top aides face corruption charges. And although Madrazo carries heavy baggage as a former governor who abused campaign-spending limits to win office, his party fared well in a recent survey by pollster Consulta Mitofsky. Some 31% of respondents said they plan to vote for the PRI in 2006, vs. 20% for the PAN and 15% for the PRD. A survey by Latinobarómetro found that just 17% of Mexicans are satisfied with the Fox administration.

Fox's failure to generate growth and push through reforms is a boon for the PRI. "The PRI has enormous possibilities of returning to power if we can advance on reforms that show the PRI's ability to get things done," says PRI congressman Francisco Suárez Dávila. He and his colleagues recently helped push through public sector pension reform, which will save the government big outlays in future years. By

yearend the PRI is expected to vote for a bill that could slash the corporate tax from 33% to 28%.

The PRI is not out of the woods.

Business leaders, who blame Madrazo for scuttling a major tax overhaul in 2001 and 2003, believe his embrace of partial reforms is mere electoral opportunism. And Madrazo, who has feuded with other PRI leaders, runs the risk of splitting the party. In the end it will come down to votes from people such as postal worker Herrera. If her disillusionment with Fox is any indication, the PRI has a chance to recover the presidential chair it held for so long. ■

—By Geri Smith in Mexico City



MADRAZO
Steering the PRI
away from
obstructionism

GLOBAL WRAPUP

EUROTUNNEL'S LATEST FINANCIAL CRUNCH

EUROTUNNEL, the operator of the English Channel tunnel, is expected to propose drastic cost cuts in a bid to renegotiate nearly \$11 billion in debt. The company is to unveil a three-year turnaround plan by Oct. 31, the opening move in talks with creditors including British bank HSBC, France's Crédit Agricole and BNP Paribas, and U.S. reinsurance group MBIA Inc.

Unless creditors approve a new agreement, EuroTunnel will be unable to meet debt payments coming due in early 2006. Although unions representing EuroTunnel's 1,400 employees will fight bitterly, job cuts appear likely. The company on Oct. 19 reported that third quarter revenues fell 4%, as ferry operators cut prices to lure freight trucks and passenger cars away from Eurotunnel's rail shuttle service.

THE JUNTA CASTS A NEW SHADOW OVER BURMA

THE DISMISSAL of Burma's Prime Minister General Khin Nyunt and his replacement by hardliner Lieutenant General Soe Win on Oct. 19 likely represents a setback for the country's hopes of moving toward democracy after decades of military rule. While hardly a liberal, Khin Nyunt, who was appointed in August 2003, had unveiled a seven-stage "roadmap" aimed at crafting a new constitution and eventually returning Burma to civilian rule. Human rights advocates also hoped for the release from house arrest of pro-democracy activist Aung San Suu Kyi. Now, despite calls from the U.N. and neighboring governments for continued progress toward democracy, the junta's shakeup may augur a new crackdown.



Net Phone Calls, Free—and Clear

Skype's radical technology and marketing threaten the very foundations of telecom

ERIKSEN TRANSLATIONS Inc. is a small business with a big footprint. The Brooklyn (N.Y.) company relies on 5,000 freelancers scattered around the world to help translate business documents into 75 languages for U.S. clients. That means phone bills of about \$1,000 a month. So when business development manager Claudia Waitman heard about a new company called Skype Technologies that offers free voice calls over the Internet to other Skype users anywhere in the

world, she jumped. Six months after signing up, Eriksen's phone costs already have fallen 10%. Even better, its employees and freelancers confer more often, allowing them to work faster and more efficiently. "It has changed the whole way we work," Waitman says.

Stories like this are popping up all over these days. More than 12 million Web surfers have downloaded the free Skype software and registered as users since the program appeared 14 months ago. The software turns a PC equipped with a microphone, speakers, and broadband con-

CEO ZENNSTROM
"Nobody else has a business model as good as ours"

nection into a 21st-century telephone. Placing a call to another Skype user is as easy as clicking

on a name in a pop-up window. Up to five people can pile into a free conference call, and the sound quality is often better than that of conventional phones. Skype's growth is accelerating as subscribers urge their friends to come aboard. The number of new registered users is now 70,000 a day, up from 30,000 in May. "Skype is leading the charge into Internet telephony," says analyst Katja Ruud of market researcher Gartner Inc.

WORD OF MOUTH

SKYPE IS THE BRAINCHILD of two notorious iconoclasts. It was invented by Niklas Zennström, a 39-year-old Swede, and Janus Friis, a 28-year-old Dane—the same duo who infuriated the recording industry when they created the popular KaZaA music-downloading service in 2000. Now they're doing it again.

With operations in London and Tallinn, Estonia, Skype is such a radical departure from any previous phone company that it threatens the very foundation of the trillion-dollar-a-year telecom industry. It has no phone lines or pricey switching equipment of its own, instead using subscribers' PCs and the public Internet to run its network. And rather than spending millions on marketing, the 70-employee company relies entirely on word-of-mouth. The result is a cost structure major phone companies can't touch. "Nobody else has a business model as good as ours," says Zennström.

While many outsiders think of Skype as a gimmicky way to get free calls, the Scandinavian pair are serious about turning it into a real business. The strategy: Accumulate as many subscribers as possible and then start selling them services such as voice mail, call waiting, and follow-me calls. Zennström compares Skype to Yahoo! and Google, which also started out free and now rake in money by marketing to millions of loyal customers. Two months ago, Skype launched its first revenue-generating service, called SkypeOut, which lets subscribers place calls from their PC to regular phones for about 2¢ a minute. The company won't say how much SkypeOut is pulling in, but 230,000 people have signed up, buying a minimum of 10 euros, or \$12.40, in prepaid calling time. That's at least \$2.8 million in revenues.

Next up is a push to attract more corporate customers. On Oct. 6, Zennström announced plans to roll out services next year

Already, that ambition is drawing rivals' ire. AT&T points out that Skype doesn't control its own network, so it can't provide the dependability required by most corporations. "Our customers demand quality and reliability most of all," says William R. L. Smith, president of AT&T's European unit. Others, including SBC Communications Inc., accuse Skype of freeloading by using established companies' networks to provide services. SBC, for one, is asking regulators to make Skype pay for access to local networks. "I was brought up believing if someone uses something, they should

To be sure, Skype isn't the only company offering phone calls over the Net. The first such services emerged a decade ago amidst much hoopla, but they foundered because the technology was immature. Now, thanks to growing penetration of broadband connections that boost the quality of Net telephony, startups such as U.S.-based Vonage Holdings Corp. are signing up hundreds of thousands of users for so-called Voice-over-Internet Protocol (VoIP) service. Some telecom giants, such as AT&T and Britain's BT Group PLC, have

Although Zennström won't discuss Skype's profitability, the company's low costs mean that, with a large enough base of customers, it ought to be able to make money even if only a small fraction of them pay for extras. The most compelling question, though, is how quickly Skype's technology and business model will begin to reshape the rest of the telecom business. It won't happen overnight, but an inexorable shift away from the old way has already begun. Just ask the folks at Eriksen Translations. ■

BusinessWeek online For a Q&A with Niklas Zennström and a Skype review, go to www.businessweek.com/magazine/extra.htm

3 Calls from one Skype user to another are free and unlimited, just like instant messaging or e-mail. And a new service lets users make calls to conventional phones for about 2¢ a minute. Skype is now adding services aimed at businesses.

November 1, 2004 | **BusinessWeek** | 61

Can EMC Find Growth Beyond Hardware?

It has outgrown mere storage. Now it wants to manage every part of the corporate data flow

HAS ANY COMPUTER company had a more dramatic reversal of fortune in the past three years than EMC Corp.? Sales fell 40% from 2000 to 2002, turning \$1.8 billion in profits into \$626 million in losses. But on Oct. 19, the data storage giant and icon of the New Economy reported a 34% surge in third-quarter sales, to \$2.0 billion, its fifth straight quarter of 20%-or-better growth. Sales and gross margins at the Hopkinton (Mass.) company are approaching their boom-time levels. And with a 21% share, it is once again tops in the \$15.4 billion storage market, ahead of Hewlett-Packard Co. and IBM, according to market researcher IDC.

But don't break out the Veuve Clicquot just yet. Act II of this comeback drama is full of suspense. Chief Executive Joseph M. Tucci has devised an ambitious plan to transform one of the most successful hardware companies of the 1990s into something quite different. In a bid to make EMC a key ally for corporations, on par with IBM and Cisco Systems Inc., he's pushing further into selling software and consulting services, while giving customers more options in hardware. The idea is to remake what has been a one-trick pony into a versatile workhorse that can solve companies' toughest tech challenges. "EMC now needs to become multiple companies," says Gartner Inc. analyst Carolyn DiCenzo. "They can't fail. They will lose everything if they fail."

Tucci is taking aim at one of the biggest technology issues for Corporate

America: the rising tide of data. As the amount of information they generate is exploding, companies are struggling to figure out how to turn all those bits and bytes from a liability into a competitive advantage. Every tech company claims to have the solution, but only EMC is building its sales pitch on storage expertise. If it can help customers move, organize, and manage data more efficiently, it could win a prime position in executive suites around the globe, assisting companies as they launch initiatives and plot strategy. That would be a huge leap from a few years ago, when EMC simply pushed customers to buy more hardware. "I want to solve your information needs, not your storage needs," Tucci says. "[We want to be a company] you can't live without."

Tucci, a 57-year-old Brooklynite who took over as CEO just months before EMC's sales crashed in 2001, has little choice but to diversify. Prices for the sophisticated storage systems it makes are tumbling, down nearly 90% since 1999, to \$26 a gigabyte last year. The result is that even though demand for storage capacity will grow 55% this year, industry revenues are on track to rise only 7%, says IDC. Meanwhile, rivals are storming the field, assuring that competition remains

cutthroat. On Oct. 12, IBM made what it called its most important move in storage in a decade, launching two powerful new systems. "We're going to be No. 1 [in storage] in a few years," says IBM Senior Vice President William M. Zeidler.

Neutralizing that threat is requiring fundamental change. In the past year, EMC spent \$3.6 billion on three big software companies. While that has boosted the company's margins and growth, it also has resulted in a host of unfamiliar challenges. EMC needs to manage more businesses than ever before, stitch products together into bundles it can charge a premium for, and sell software independent of its hardware for the first time. Some wonder if Tucci can deliver on his grand vision. "I have a great deal of respect for EMC," says Daniel J. Warmenhoven, CEO of rival Network Appliance. "But they're overreaching by a lot."

Fortunately, EMC is standing on a solid base. Revenues for the year are expected to surge 30%, to \$8.1 billion, not far from 2000's \$8.9 billion. Net income is projected to jump 71%, to \$850 million. And non-hardware revenues—softwar-

Diversifying is a no-brainer: Hard disk prices are tumbling

Tucci's Transformation

CEO Joe Tucci wants EMC to be more than just the dean of data storage. His ambitious goal is to build EMC into the leading manager of corporate data. For this plan to work, Tucci must:



and services—have more than doubled since 2000, raising gross margins to 51%, not far from the 58% peak four years ago.

EMC is counting on a new sales pitch to keep the momentum going. With customers facing limited budgets, it's offering to help them devise strategies for making do with less. With tools that can automatically move stored information between systems, less critical content such as old employee e-mails is shunted into inexpensive hard drives, while vital data like online-sales transactions are kept on high-end systems that back up constantly and allow instant retrieval.

For big corporations suffocating under

mountains of data and in no mood to shell out for more hardware, smart systems such as these are a big draw. Take Bear Stearns Cos. Inc. The investment bank is investing millions in EMC hardware and software that allows it to move and manage data based on their relative value, the risk if they are lost, and new federal rules on retaining communications like e-mails. To ensure operations are never interrupted, the system constantly produces duplicate copies of vital information, such as records of equity

TUCCI "I want to solve your information needs, not your storage needs"

trades, in two separate data centers from which it can be retrieved in a flash. The next step is to automate data management at every step, removing the need for human intervention and saving time and money. "They've just hit the tip of the iceberg," says Bear Stearns Chief Technology Officer Peter D. Cherasia.

ADD TO SHOPPING CART

THAT'S ONE REASON EMC will probably continue to prowl for acquisitions. Analysts say logical targets include companies that make software that runs well on EMC hardware, such as privately held CreekPath Systems and OuterBay Technologies, as well as businesses with software for managing servers and software applications, such as BMC Software and Mercury Interactive. And to compete with HP and IBM's armies of consultants, EMC will probably need to add to its expertise through acquisitions of small and midsize services and systems-integration firms. "At some point they're going to have to do some pretty big things," says IDC Vice-President John McArthur.

Tucci declined to comment on potential targets, except to say he'll keep "expanding the pie." On Oct. 12, he picked up Dantz Development Corp., a small, privately held developer of backup and recovery software for small and midsize businesses. EMC said the purchase price was less than \$50 million.

Meantime, EMC's rivals are pushing hard to keep pace. HP, which stumbled badly in the corporate market in the second quarter, is expanding its storage sales force by 25%. Hitachi Data Systems, whose gear is resold by HP and Sun Microsystems, is promoting a high-end machine that it says is four times faster than EMC's top-of-the-line model with twice the capacity. "There is no EMC comparison to this product," says Boris Sherman, director of enterprise architecture at United Airlines Inc., which is testing the product.

But EMC's chief is betting the storage game has changed. Even as storing data has become a top priority, most customers are more interested in hardware being smart than speedy. "The last thing that impresses me is how fast my car goes," says Tucci, whose collection includes a silver Porsche capable of topping 185 mph. "It's functionality." He had better hope so. EMC looks more like an all-terrain, do-everything SUV than the nimble sports car of old. Keeping it hugging the curves is only going to get tougher. ■

—By Andrew Park in Hopkinton, Mass.,
with Steve Hamm in New York

MADE SOFTWARE

EMC has already boosted software sales to \$1 billion in revenue, from 17%, in 2000. Now, he has to sell more software with hardware and services.

KEEP SHOPPING

He has spent \$3.6 billion in the last year on software acquisitions like Legato and Documentum. Possible targets: BMC, Mercury Interactive, and CreekPath Systems.

BOOST CONSULTING

He sees EMC helping clients turn stockpiles of data into competitive weapons. IBM and Hewlett-Packard are pursuing a similar plan.

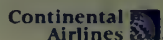
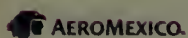


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AT MOST CORPORATIONS, BUSINESS TRAVEL IS ONE OF THE TOP THREE CONTROLLABLE COSTS. That makes travel purchasing – and cost control – an urgent corporate priority. Fortunately, important new electronic tools are boosting the effort, streamlining the travel purchasing and expense reporting process and improving corporate oversight of T&E spending.

At the same time, better information on spending patterns and volume gives travel managers the ammunition they need to negotiate discount agreements with airlines, hotels and car rental companies. How are some of the world's most progressive companies managing travel costs? Here are some tried-and-true strategies:

Book as much as possible online.

According to various surveys, significant cost savings are being reaped when companies encourage travelers to book their own reservations online instead of through a travel agent. In the most recent GetThere survey, respondents said that average airfares booked online were 15 percent lower than those booked over the phone, and average travel agency service fees were nearly 50 percent lower than if a company had no self-booking option. Those lower fees and rates translate to about a \$75 savings on a \$500 airline ticket.

Keep an eye on compliance. It's one thing to set a travel policy; it's another to give it 'teeth.' Talk to your travel management company about setting up technology solutions that help identify errant spenders by capturing out-of-policy bookings at point of sale – whether it's charged on the corporate card, through a travel agent, or via an online booking. At American Express, for example, a new series of reports help T&E managers identify travelers who book 'Web' fares rather than a firm's negotiated airfares.

"Variance reports will make my life a lot easier," said Lorraine Rostanzo, director of global travel and support services, at Columbia, Maryland based W.R. Grace & Co. "The big advantage is that they'll clearly point out the variance between booked and charged data, and I'll be able to drill down to the transaction level. Not only will it help me identify the total cost of an airline ticket, it will be much easier to identify employees who use the approved Card but not the approved agency, as well as those who book Coach and charge



ILLUSTRATION BY RAFAEL LOPEZ



A growing trend is for travel managers to set up a live, online auction during which suppliers bid against each other by offering lower and lower prices.

an upgrade to First Class at the airport. The reports will also be another tool to keep track of vendor leakage to maintain the integrity of my programs."

Do an analysis of value added tax (VAT) reclaim opportunity. More than 100 countries, including the 25 countries in the European Union, plus Japan, Korea and

Regularly analyze T&E card data, and take that information to vendors. Engelhard Corporation, the surface and materials science company, recently increased its use of global contracts for air, lodging and car rental across its 20 operating regions worldwide, and is already seeing results. According to Danny Hughes, Engelhard's director of corporate purchasing, the information gleaned from its American Express Corporate Card has helped the company negotiate deals that significantly pared Engelhard's average domestic U.S. and international airfares and worldwide lodging and car rental rates, while improving volume to its preferred vendors.

Spending information can also come from suppliers as well. This month Hilton Hotels began offering electronic retrieval of hotel folios to ensure that expense accounts are accurate and complete. Travelers who have a profile on file with Hilton will be able to

an administrative assistant, an independent meeting planner, a corporate travel agency or in-house meeting department — there will be an established way to drive group volume to preferred airlines, hotel chains, individual properties, and transportation suppliers.

Set up reverse online auctions in key markets. A growing trend is for travel managers to set up a live, online auction during which suppliers bid against each other by offering lower and lower prices. Most reverse auctions in the travel space are for hotels, but many travel managers have begun using them for ground transportation as well.

Consider airline alliances when making supplier agreements. The biggest news this year in the alliance world is SkyTeam's expansion; in September, it welcomed Continental, KLM and Northwest Airlines to the group. The combined network now provides more than 14,000 daily flights to 658 destinations in 130 countries.

Airline alliances offer travelers several advantages — more flight options, a single check in for connecting flights and baggage, faster ways to build frequency points, and access to airport lounges (SkyTeam's total: 338). Passengers traveling with any of the nine member airlines (Aeroméxico, Air France, Alitalia, Continental, CSA Czech Airlines, Delta, KLM, Korean and Northwest) can earn miles towards SkyTeam Elite status and redeem miles on any SkyTeam partner.

For travel managers, alliances make it easier to make global agreements, since alliances can offer multinational companies a single contract for travel on the network. According to *Business Travel News*, Delta's North American sales team now is selling to corporate clients the complete range of services offered by Korean, an arrangement Delta called a first between U.S. and Asian carriers.

CORPORATE TRAVEL WEB RESOURCES

Embassy Suites Hotels

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TripRewards members can redeem their points for either hotel stays — with no blackout dates — or partner rewards, including airline tickets, resort vacations, electronics and gift certificates from 46 retailers and restaurants.

A hassle-free online system allows members to check points and redeem for rewards 24 hours a day. For information, call (800) FOR-TRIP.

Canada, levy VAT — also known as IVA, GST, MwST, TVA, and MOMS. The tax is added not only on hotel rooms, train tickets, rental cars, gasoline, and meals but also on certain conferences and trade shows. Because most of these countries will refund part or all of the tax to companies that apply for the refund and supply the necessary documentation, it can be well worthwhile for firms to go through the complex exercise of VAT reclaim. Several firms, including Seattle based Corporate VAT Management, offer technical solutions that link charge card activity and expense report software, flag expenses with recoverable tax, and identify where it's most cost effective to initiate the reclaim process.

retrieve and print their final hotel folio 48 hours after checking out. Folios will be available online for stays at any of the Hilton brand hotels for three months. "Travelers often use express check out, but then incur charges for breakfast, parking or the telephone that aren't on the folio before they leave the property," said Rebecca Wyatt, senior vice president of electronic distribution and customer relationship marketing for Hilton. "Then there's a discrepancy between the folio they agreed to and the card statement. Online retrieval allows travelers to file the amended folio for expense reporting purposes."

Centralize meeting site selection. That way, no matter who is planning an event —

Embassy Suites: The First in All-Suites is Still the Leader

All-suite hotels are quickly gaining traction among both business travelers and their CFOs. Guests (and CFOs) like the idea of two rooms for the price of one – especially if the suite can double as office space and a meeting room.

Not all suite hotels are the same, however, and brands are employing rather inspired strategies to provide the kind of amenities and aesthetics their customers have grown to expect.

Embassy Suites Hotels, which invented the all-suite chain 20 years ago, is still pioneering the genre. It recently launched a new room concept called the Creativity Suite, designed to inspire road warriors and make their brainstorming sessions easier. All Creativity Suites come with an iMac computer; sectional sofas that can easily be rearranged for meetings; a wall covered with chalkboard paint; and selection of art supplies that's part of each suite's "invention box." Even the shower features a writing board and grease pencils.

For meetings of up to 10 participants, many Embassy Suites properties feature fully-equipped conference suites. A quick phone call can arrange audiovisual support and catering.

For larger events, Embassy Suites properties feature state-of-the-art facilities and top-notch meeting support capabilities. A new, searchable database of Embassy Suites properties allows planners to perform site searches quickly and effortlessly. Enter location, room counts and meeting room needs, and you'll be able to view floor plans and 360° panoramas to find the perfect facility for your event.

On a budget? The Group Value Dates feature allows you to select Embassy Suites hotels with available guest rooms and function space at 10 to 30 percent or more off seasonal rates, where applicable. Embassy Suites even provides free meeting planning software, which allows planners the ability to design various room configurations online.

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COMMENTARY

BY PETER COY

When Home Buying By the Poor Backfires

For many families, a house can be a bad investment

MILDRED WILKINS calls it “falling out the back door.” It’s what happens when low-income families who have bought their first houses are forced out because they can’t keep up the mortgage payments. Says Wilkins, an Indianapolis consumer advocate who once worked for Fannie Mae selling foreclosed properties: “I don’t care if you put five families in the front door if three families fall out the back door. It breaks my heart to see it. It absolutely breaks my heart.”

In Washington, making it easier for the poor to buy homes is as uncontroversial as Mom’s apple pie. Measures to increase the rate of low-income homeownership have historically been strongly supported by both Democrats and Republicans, as well as homebuilders and banks. Fannie Mae and Freddie Mac, the giant mortgage-finance institutions, have justified their existence by their promotion of homeownership among the poor. More recently, boosting low-income home buying has been an important part of what President George W. Bush calls the “ownership society.”

Unlike many government initiatives, the homeownership campaign is succeeding: The nation’s homeownership rate reached a record 69.2% in the second quarter, up from 67.2% four years earlier. Among families in the bottom half of incomes, the rate rose to 53.1% from 50.8% over the same stretch. Advocates say ownership builds wealth while promoting responsibility.

Misguided Policy

BUT THE STEADY PUSH of homeownership to lower and lower income groups, while positive in many ways, is not an unadulterated good. Despite conventional wisdom, extensive research has shown that homeownership is not the most reliable means of building wealth for low-income families, especially those with unreliable incomes and few other investments. Over the long run, home prices tend to rise more slowly than other assets, such as stocks. Moreover, poor families are now so easily able to tap their home equity to pay pressing bills that many don’t accumulate wealth. Finally, as more poor families

buy homes with low-downpayment mortgages, the odds of seeing their investments wiped out goes way up. Such loans make it easier to get in the door but raise monthly payments

That’s a message few people want to hear these days, with homeownership the main plank of national housing policy. Last year Congress passed the Bush-backed American Dream Downpayment Act, which gives money to low- and moderate-income families to help cover their downpayments for Federal Housing Authority-insured properties. In his reelection campaign, Bush has advocated allowing the FHA to insure loans that involve no downpayment at all, compared with the current minimum of 3%. Meanwhile, Fannie Mae is aggressively promoting lending to low-income families. Where it once bought only loans with 20% downpayments, now it supports offers such as “Special 100,” which requires no downpayment.

The most important argument of those who advocate increasing homeownership among the poor is that instead of throwing away money on rent, they can automatically save money and build wealth by paying off their mortgages. As owners, they are in a position to benefit from rising home prices. Says a 2002 study by the Housing & Urban Development Dept.: “Over time, purchasing a home has proven to be an effective wealth-building strategy for millions of Americans.... When housing prices rise, the benefits flow to all income levels.” That has certainly been true lately: Single-family house prices rose 44% over the past five years, according to the Office of Federal Housing Enterprise Oversight, the agency



at oversees Fannie Mae and Freddie Mac. But it's essential to remember that the recent runup in housing prices is highly unusual. From 1975 to 1995, the inflation-adjusted rise in house prices nationally was just 0.4% a year.

Moreover, home prices can stagnate for long periods or even fall—especially if they're as high as they've gotten recently. Harvard University study of house sales in Philadelphia, Boston, Denver, and Chicago from 1982 to 1999 found that sellers of low-priced homes lost money 20% to 40% of the time, once transaction costs were taken into account. Not surprisingly, the odds of taking a loss were higher if the seller bought after prices had already risen. "Whether homeownership is a good or bad investment clearly depends on the time of purchase," concludes another study led by Karl E. Case, a Wellesley College economist.

On top of that, returns on housing tend to be lower than returns on stocks—and the risk is high when the vast majority of a family's wealth is tied up in a single, undiversifiable asset. Economists William Goetzmann and Matthew Spiegel of Yale School of Management argue that low-income homeowners would do better investing in lower-risk, more-liquid assets such as stocks and bonds. In a 2001 paper, they wrote that "it seems likely that sometime in the next 20 years a substantial number of the beneficiaries of this policy [of promoting low-income homeownership] may find their meager savings severely diminished, if not totally depleted."

The argument that owning a house forces low-income families to save is also flawed. It used to be that homeowners would be forced to save as they paid back the principal on their mortgage loan. Today, however, it's easy to get home-equity loans, which allow people to extract whatever wealth they've accumulated. That may be good in the short run, but it undercuts the goal of building wealth. These days owning a house is no more a means of forced savings than putting money into stock mutual funds is.

Several other factors make homeownership a worse deal for low-income families than for the middle class and the wealthy.

SOMETIMES BUYING A HOME DOESN'T BUILD WEALTH

Low-income home buyers take on big risks in exchange for uncertain gains.

THEY MAY HAVE TOO MUCH of their wealth tied up in housing, an asset that has relatively low long-term returns.

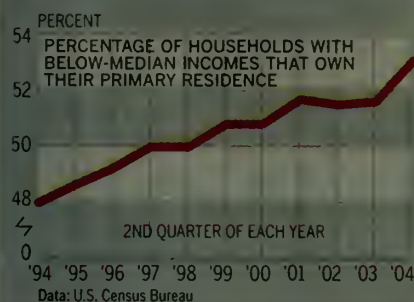
THEY TEND TO PAY higher mortgage rates while getting fewer tax benefits from the deduction for mortgage interest and property taxes.

THEY MAY BE FORCED to borrow against equity rather than building wealth. Easy home-equity loans mean there's less forced saving.

THEY ARE AT GREATER RISK of defaulting in periods of high unemployment, seriously damaging their credit records.

GETTING IN THE DOOR

More lower-income families own homes



Some 4.6% of subprime loans are in foreclosure, vs. just 0.5% of primes

For one, they usually pay higher rates for mortgages. For another, many don't fully benefit from property-tax and mortgage-interest-payment deductions, which are worth less for families in low tax brackets. And for an inexpensive house, deductible housing expenses can be less than the standard deduction: \$7,150 for head-of-household filers this year.

Advocates of wider homeownership correctly observe that a house is the only asset a family of limited means can buy with a big loan, which juices returns. "Because home buying is a highly leveraged investment, potential increases in the values of homes can bring rich returns," the HUD study notes.

Leverage, however, is a two-edged sword. With very small downpayments, it's easy for the price of a house to fall below the amount remaining on the mortgage. When that happens, it's impossible to extinguish the debt by selling. Making matters worse, house prices tend to fall when

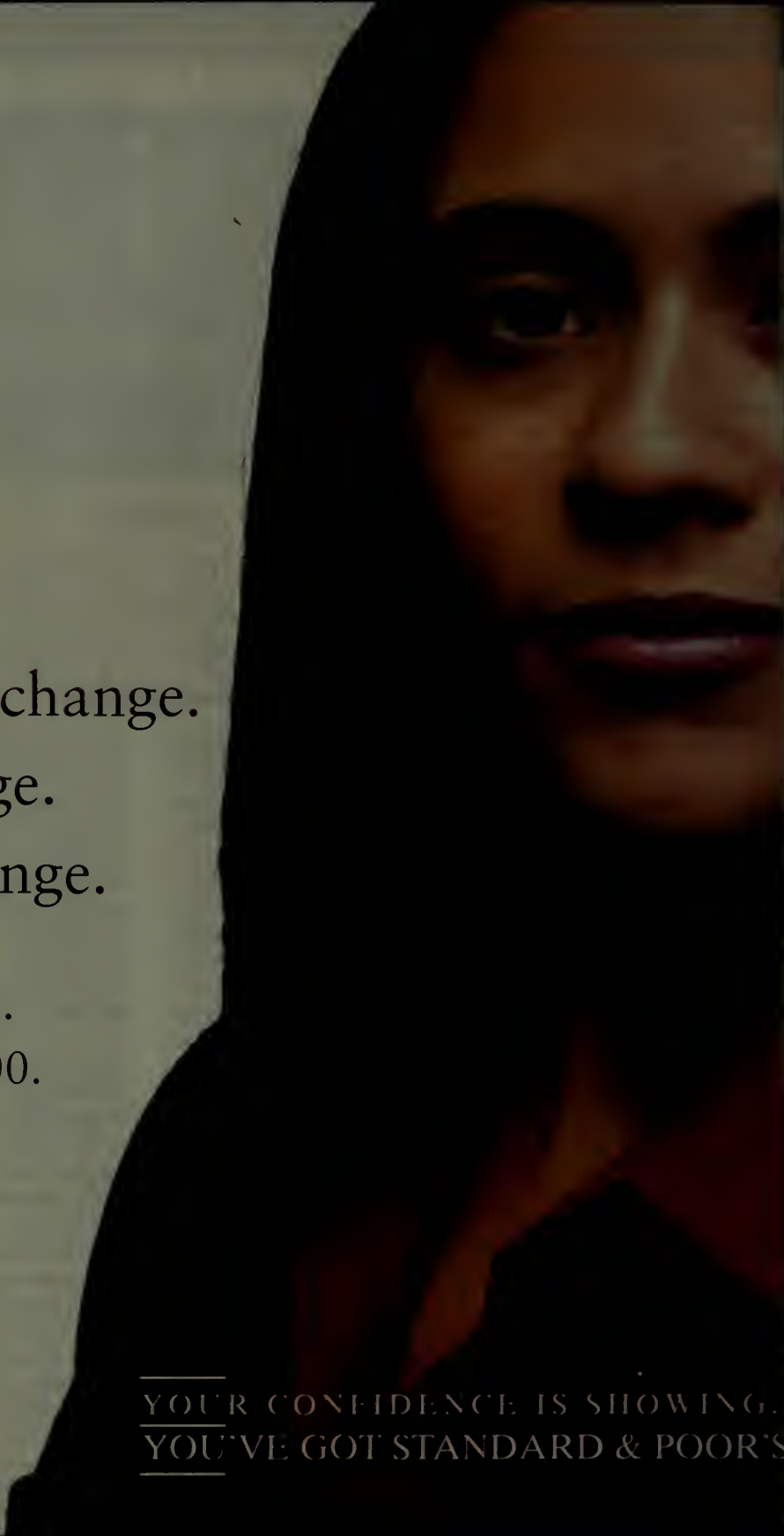
the economy weakens—and because of the nature of their work, low-income families are more exposed to layoffs in downturns. So they can't sell, and they can't make payments because they're jobless. That's a recipe for foreclosure. According to the Mortgage Bankers Association of America, 4.6% of subprime loans—most of which go to low-income families—were in foreclosure at the end of the second quarter. That compares to just half a percent of prime loans. Nearly 10% of subprime loans were in foreclosure in Indiana, where Mildred Wilkins is president of Home Ownership Matters, an advocate for responsible lending.

Losses Beyond the Financial

WHEN CONGRESS PASSED the Community Reinvestment Act in 1977, it was because banks wouldn't make loans in poor areas. But the tide has turned. Now many banks and finance companies specialize in high-rate loans to low-income families—generating so many loans that federal regulators are proposing to exempt small banks from the rules. Subprime lenders earn enough money on the loans that don't go bad to swallow some foreclosures. That would be fine if investors bore the full cost of those losses, but they don't. The most important losses are felt by the families who lose their homes and the neighborhoods they live in, says Paul Bellamy, executive director of the Lorain County Reinvestment Coalition in Ohio.

Homeownership does have some important social advantages. Economists such as Harvard's Edward L. Glaeser have found that homeowners are more likely to vote for measures that have short-term costs and long-term benefits, such as new roads. People also take better care of properties they own. Studies by Donald R. Haurin of Ohio State University and others have found that children of homeowners do better in school than children of renters, holding other factors constant.

Up to a point, there's no doubt that raising homeownership rates for the poor is a plus. But after years of trying to insure that poor and minority families have access to mortgage credit, the pendulum may have swung too far. As economics teaches us, everything comes to a point of diminishing returns—including homeownership. ■



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The BusinessWeek/ Architectural Record Awards

In one of the toughest contests of its kind, we scrutinize both design and function: The focus is on solving client problems and achieving business goals. Here, the winners—and some finalists, too

EACH YEAR *BusinessWeek* joins with *Architectural Record*, a sister publication at The McGraw-Hill Companies, to run a contest that rewards exceptional architecture around the world. The contest goes beyond the usual aesthetics applauded in most architectural awards programs. Sponsored by the American Institute of Architects, the *BusinessWeek/Architectural Record* Awards program includes both architects and businesspeople on the jury. It is one of the toughest contests to win, requiring a series of precise metrics on how architecture is used to solve specific client problems.

AUCKLAND, N.Z.
The airy, glass Britomart Transport Center

This year, *BusinessWeek* is trying something new. It is writing up not only many of the winners but also several of the finalists. We felt our readers would have a special interest in how General Mills Inc. expanded its world headquarters to integrate a new acquisition, Pillsbury, into its



strong corporate culture. Designing the new Quintessa Winery in St. Helena, Calif., so that it fits smoothly into the beautiful surrounding Napa Valley vineyards is an intriguing tale. And so is saving an historic building in Washington,

D.C., by retrofitting it into the modern Monaco Hotel. These are all stories of how architecture was used to achieve major business goals.

There was great diversity among the 10 winners and 9 finalists the jury chose to reward out of the 208 entries in 2004. We had a martial arts center, a transport hub, a foreign ministry, a homeless shelter, a museum, a hotel, a Humane Society building, and a winery. There were winners and finalists from the U.S., Canada, New Zealand, Japan, Israel, and Ireland.

All had a relationship between architect and client that solved problems. Jury Chair Moshe Safdie, principal at Moshe Safdie & Associates Inc., said the *BusinessWeek/Architectural Record* contest "is one of the few, if not the only, awards [program] that looks at [both] design and performance."

Here are some of the best.

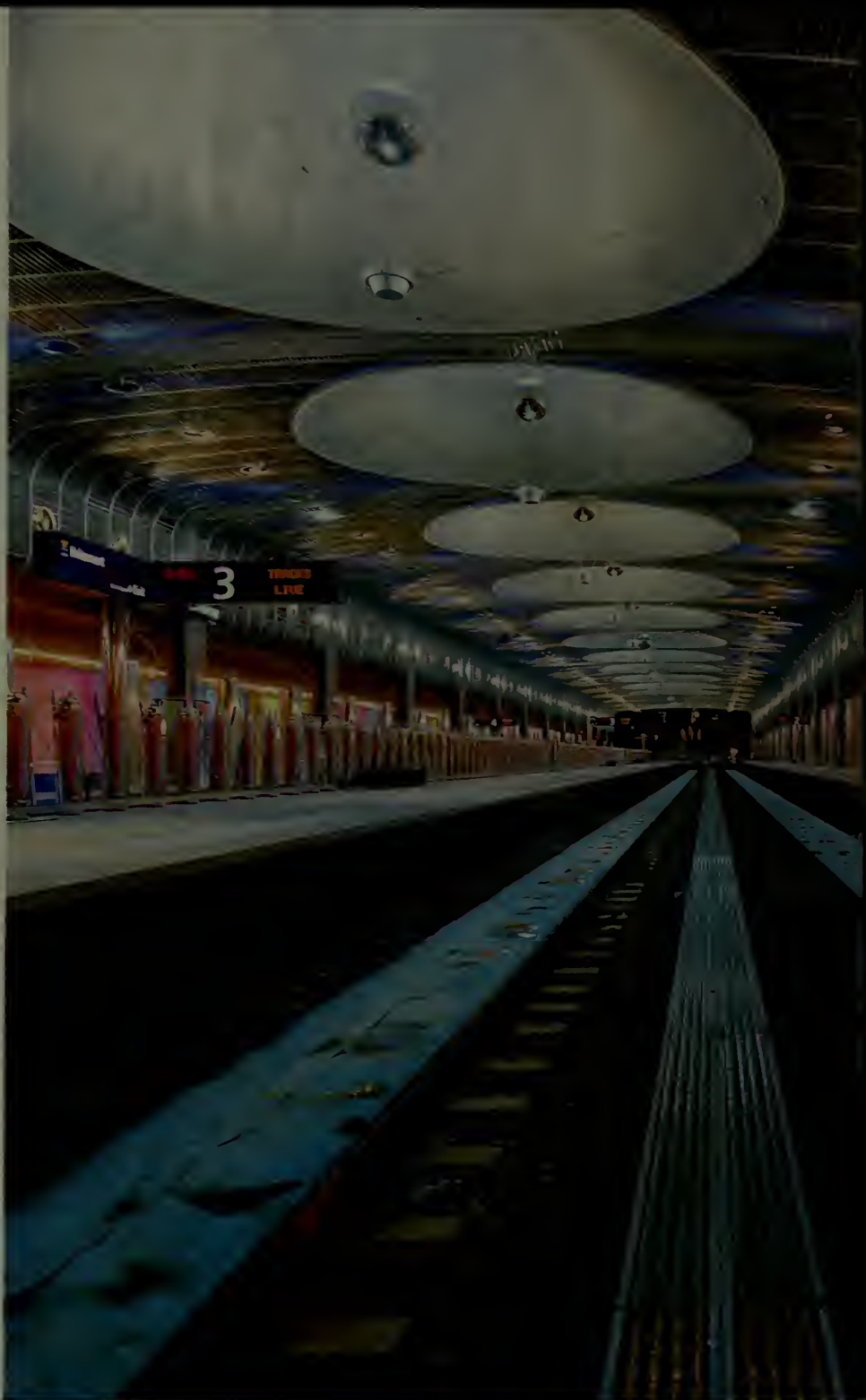
—By Bruce Nussbaum in New York

BusinessWeek online For a look at all of the winners and finalists, go to www.businessweek.com/magazine/extra.htm

Hustle, Bustle, And Beauty



NEW ZEALAND'S BRITOMART Transport Center was designed primarily to restore vitality to public transportation in the Auckland area—and, in the process, reduce automobile congestion and pollution. The city council also wanted to breathe new life into the downtown waterfront area. Finally, it needed to build New Zealand's first underground rail station because the Transport Center was near native Maori land that couldn't be disturbed. The solution was ingenious. An old, historic building, the Chief Post Office, which had been empty for a decade, was renovated. It was refashioned to serve as an entry portal to a new, large "glass house" building that functions as a public space funneling people to what is the only underground diesel train station in the



WINNER

BRITOMART TRANSPORT CENTER

Auckland, New Zealand

Client Auckland City Council
Britomart Project Group

Architects Greg Boyden; JASMAX Ltd. and Mario Madayag; Mario Madayag Architecture Ltd. (MMA)

Preservation Architect Salmond Reed Architects

world. The architects employed the glass building as well as bright, light material down inside the rail station to overcome the hesitancy of New Zealanders to venture underground for their transportation. They also borrowed motifs from Maori culture: native materials and designs were integrated into the Transport Center. Juror Douglas Gardner, former president of the Urban Development Group at Catellus Development Corp said "the project was physically daunting and complex." The architects, a young



American and his New Zealand partners, "came up with solutions that achieved a number of important goals," says Gardner. Auckland held its own competition for the transportation project and Greg Boyden and Mario Adayag won. There was a substantial amount of public input from Auckland residents into the contest that eventually was reflected in the final design.

TRAIN STATION

The design successfully revitalized downtown



QUIET REFLECTION
Employees are encouraged to stop and linger

Made for Mixing and Mingling

WHEN GENERAL MILLS Inc. bought Pillsbury, it wanted to integrate the new people into its world headquarters campus. It also wanted to take the opportunity to increase employee productivity by boosting communication.

To do that, Hammel, Green and Abrahamson Inc. designed new space to facilitate interaction to help generate new ideas. It also designed more flexible work environments that could expand and contract as the economy changes.

A new Employees Services Building was built as a town center for the headquarters campus. The ESB site was located so that employees funneled into it, raising frequency of interaction between departments. A Main Street arcade of ameni-

ties was provided—credit union, deli with take-home food service, juice bar, and coffee shop—to encourage people to stop and linger. A separate new five-story office building was also put up to accommodate the new Pillsbury employees. Says juror Betsy Cohen, Chairman and Chief Executive Officer, Resource Asset Investment Trust, "It was driven by the HR department, and the spaces that were developed were very much within

the program of employee satisfaction." The project was delivered ahead of schedule and under budget: In January, 2002, the board of directors approved it. In January, 2003, the ESB and office buildings opened. The jury wanted a more dramatic architectural solution, so the project was a finalist, not a winner. General Mills' employees may beg to differ.

FINALIST

GENERAL MILLS WORLD HEADQUARTERS
Golden Valley, Minn.

Client General Mills Inc.
Golden Valley, Minn.

Architects Tim Carl AIA; Hammel, Green and Abrahamson Inc., Minneapolis

Building Type Expanding corporate headquarters

Distinctive, with a Mellow Aftertaste

THE GOAL WAS TO BUILD A state-of-the-art winemaking facility that would complement the bucolic serenity of the Napa Valley property while conveying the quality and elegance of the wine. In the past, the owner of Quintessa Winery had harvested grapes and sent them out to independent producers to crush, ferment, and bottle. But now he wanted to build his own full-service winery, including a tasting center, production facility, and corporate offices.

The solution is a simple, sculptural, crescent-shaped building that is integrated into the hillside with seeming effortlessness. A "gravity-flow" method of

winemaking was used. Grapes are crushed above, on the terrace, and funneled down via roof hatches into fermentation tanks below.

The design minimizes the potentially damaging impact of a substantial structure on the existing vineyards and landscape by reflecting the natural contours of the geography. The use of irrigated sod roofs and night air ventilation produce natural regulation of temperature and humidity, which reduces the need for mechanized refrigeration. Visitors sample wine in a cave atmosphere and take tours of the production facilities and vineyards.

The project was a close collaboration among the owner, the winemaker, the architect, and the wine production consultant. Gathering a team of consultants at the beginning of the project allowed for a more efficient and productive design process. It also ensured that the project came in on schedule and on budget.

The design utilizes an open floor plan that will be able to accommodate changes in the future.

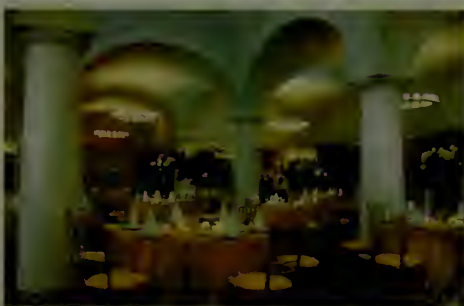
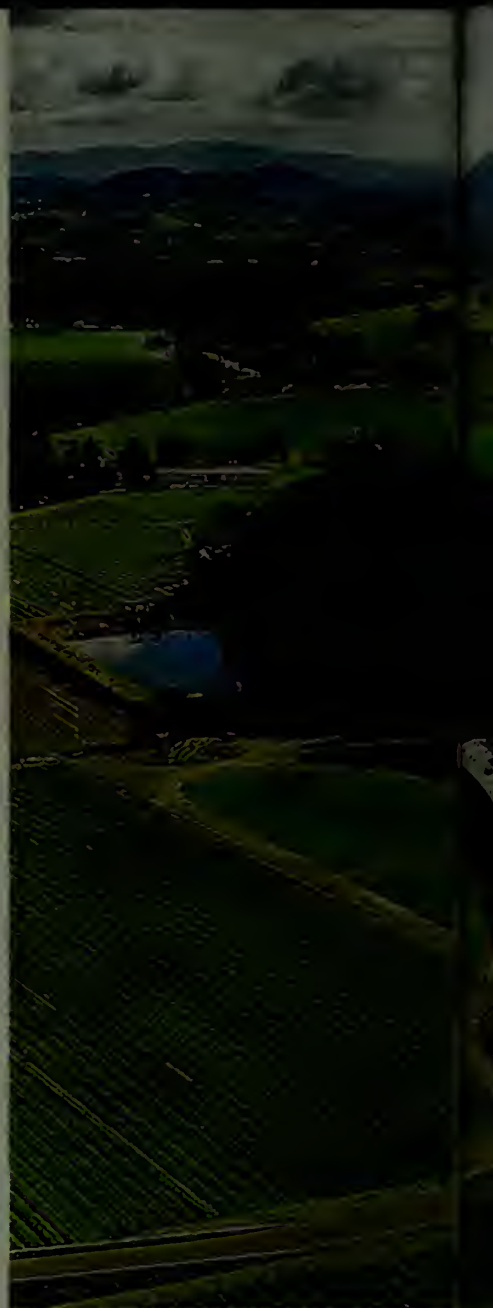
FINALIST

QUINTESSA WINERY

St. Helena, Calif.

Client Huneeus Vintners LLC, St. Helena, Calif.

Architect Greg Warner; Walker Warner Architects, San Francisco



Letter Perfect

ASUCCESSFUL PARTNERSHIP between the federal government and a private developer rehabilitated a national landmark building in Washington D.C. First erected in 1842, the Old General Post Office was transformed into the 172-room Hotel Monaco and opened in July, 2002, a fine example of adaptive reuse.

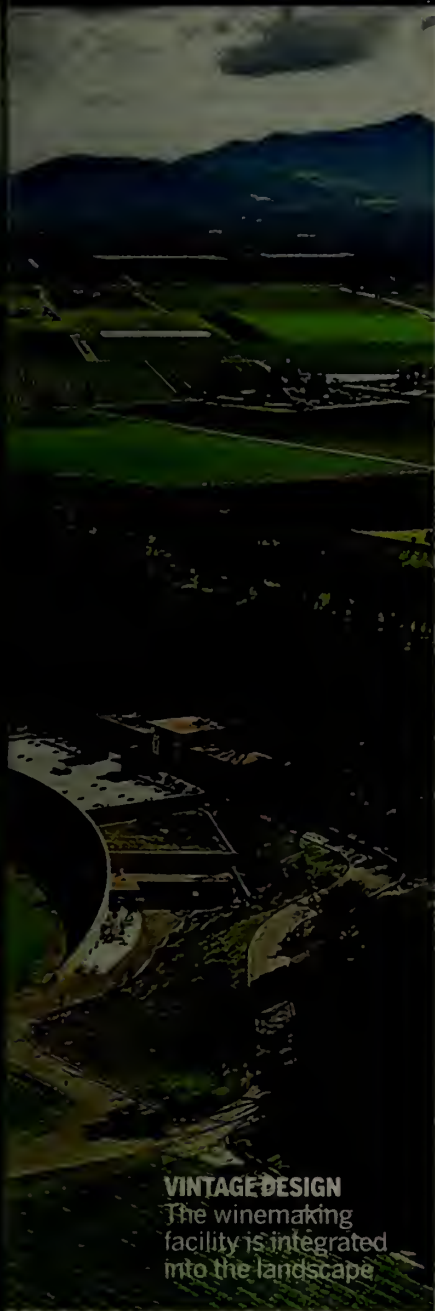
POST REHAB

The old sorting room became the restaurant

The Tariff Building, as it was known locally, was abandoned in

1995, its Renaissance Palazzo structure turning to ruin. The solution: A competition was held in which the winning developer would get a long-term lease in exchange for revitalizing the post office to use for another purpose.

The winner, Michael Stanton Architecture, washed and repainted the outside and restored the interior. The Post Office main sorting room became the hotel restaurant. The dead-letter room became the main meeting room. Guest rooms were designed to ensure that the historic



VINTAGE DESIGN
The winemaking facility is integrated into the landscape

FINALIST

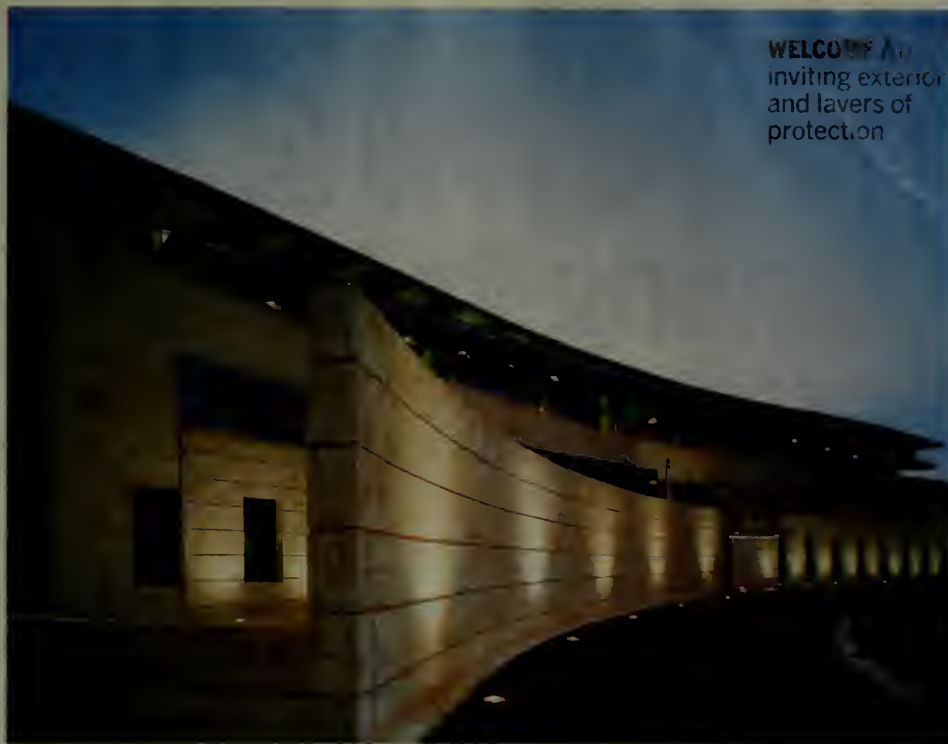
HOTEL MONACO Washington, D.C.

Client Kimpton Hotel & Restaurant Group Inc., San Francisco; General Services Administration, Washington, D.C.

Architect Michael Stanton, FAIA; Michael Stanton Architecture, San Francisco

Associate Architect Mary Oehrli, FAIA; Oehrlein & Associates Architects

abric of the old rooms was maintained. The hotel is an economic success, too, preserving a beautiful building and giving new life to a "transitional" neighborhood.



WELCOMING An inviting exterior and layers of protection

Sweeping, Stately —And Secure

ISRAEL WANTED TO BUILD A NEW Foreign Ministry that reflected both its open, democratic society and its need for security. The result is a building that integrates security requirements directly into the design so that they become invisible and part of the overall environment. Instead of high wire fences and ugly cement barriers to guard the perimeter, the architects incorporated a long, sweeping blast wall into the design of the building itself. An arrival court that can accept up to 25 cars at one time is buried within the sloped landscape to create a secure common entrance point for arriving dignitaries, officials, and staff.

Central to the ceremonial function of the ministry building is a reception hall that is used for greeting and entertaining visiting heads of state. The 75-by-

75-foot hall is enclosed with onyx panels installed on aluminum metal spring clips that can absorb the shock of an explosion from outside. The paneling protects dignitaries and others inside the hall even as it delights the eye. In addition, teak wooden screens act as a secondary layer of defense against a bomb blast that generates inward flying debris.

The Foreign Ministry building is intended to be a prototype of secure office design for other future Israeli buildings in the Middle East. The limestone-clad structure took care of the seemingly contradictory requirements of appearing accessible and inviting while maintaining a sense of protection and enclosure. As jury chair Moshe Safdie said: "It's a model...of how security can be achieved. It's actually a luxurious and very well-crafted building."

WINNER

ISRAELI FOREIGN MINISTRY Jerusalem

Client Israeli Foreign Ministry

Architect Jack Diamond, Hon. FAIA; Diamond and Schmitt Architects Inc., Toronto

Associate Architect Kolker, Kolker Epstein Architects, Jerusalem

This Pep Pill Is Pushing Its Luck

Half of Provigil prescriptions may be for "off-label" uses. Did its maker cross the line?

IT SOUNDS LIKE THE ULTIMATE pick-me-up. Provigil, the alertness drug sold by Cephalon Inc. of West Chester, Pa., started out as a niche product to treat symptoms of narcolepsy. But since its launch in 1999, the drug has soared to more than \$400 million in sales, almost half of Cephalon's revenues. Doctors now prescribe it to treat everything from attention deficit hyperactivity disorder (ADHD) to fatigue associated with multiple sclerosis and depression. And it may help the millions of clinically depressed people who take medications but continue to feel sluggish, says Dr. J. Alexander Bodkin, chief of the clinical psychopharmacology research program at McLean Hospital in Belmont, Mass. For Cephalon, he says, it could be "a complete bonanza."

The question is whether the company has crossed the line in chasing those riches. In September, Cephalon disclosed it had been subpoenaed by the U.S. Attorney's office in Philadelphia regarding its sales practices. The details of the inquiry haven't been revealed, but Wall Street analysts figure it focuses on whether Cephalon has promoted its drugs—most notably Provigil—for so called off-label uses. Doctors can use drugs to treat any condition they want. But companies can only promote their products for uses the Food & Drug Administration has approved—those listed on the drug's label. Cephalon executives declined to comment for this story, but corporate spokesman Robert W. Grupp says the company has complied with the law.

Cephalon is hardly the only drugmaker in the spotlight. Giants such as Johnson & Johnson and Genentech Inc. have disclosed that investigators are looking at whether they have improperly promoted their products. A 1999 court decision

ruled that companies could give doctors certain kinds of information on unapproved uses, including papers from peer-reviewed medical journals. That has led drugmakers to become more aggressive about communicating such information—in turn drawing the attention of investigators at the Justice Dept. and elsewhere.

COOL, CALM, ALERT

WHEN IT COMES to off-label popularity, Provigil is a standout. While the drug is approved to treat conditions like narcolepsy and a sleep disorder suffered by many people who work night shifts, SG Cowen & Co. analyst Eric T. Schmidt figures more than 50% of the drug's sales are for unapproved uses.

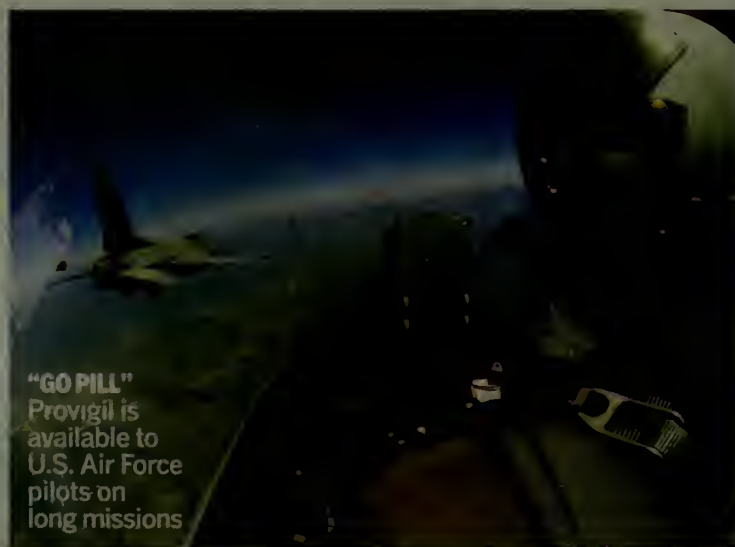
Why would a narcolepsy drug help address such a wide variety of disorders? While it is unclear exactly how the drug works, Provigil appears to stimulate the hypothalamus, a part of the brain believed to be involved in regulating normal wakefulness. The compound is a stimulant, like amphetamines, but does not significantly

increase activity in the central nervous system. So while amphetamine users may feel wired and jittery, Provigil users generally do not. "There are very few side effects," says Dr. Thomas Scammell, associate professor of neurology at Harvard Medical School. "People who take it stay calmly awake."

While millions in our 24/7 society might crave an energizing elixir like Provigil, it seems much of the off-label use stems from people who suffer fatigue from diseases such as depression, Parkinson's or MS. Some studies—a number which were paid for or conducted by Cephalon—have shown the drug can reduce the lethargy or sleepiness associated with those ailments or their treatment. The U.S. Air Force has adopted Provigil as one of its official "go pills" for some pilots whose missions stretch out more than 10 hours. And in studies of children with ADHD, Provigil helped reduce symptoms which may be caused by inadequate stimulation of parts of the brain.

Researchers are also studying Provigil as a treatment for debilitating lethargy and other effects of long-term cocaine use. They are finding that it actually dimmed the cocaine high, making the drug less appealing to users. Says Dr. Charles A. Dackis, chief of psychiatry at Presbyterian Medical Center in Philadelphia: "One patient even got into a fight with his dealer because he thought I sold him bad cocaine."

For a small company like Cephalon, these are all tantalizing opportunities. And while interviews with physicians and researchers did not reveal evidence that the company has improperly marketed the drug, it is clear Cephalon has tried to get as much information as possible out to prescribing doctors around the country.



"GO PILL"
Provigil is available to U.S. Air Force pilots on long missions

Losing Sleep

The following off-label uses of Provigil have drawn scrutiny and could keep maker Cephalon awake at night:

Take the use of Provigil to treat children with ADHD—a \$1 billion-plus market. In August, Cephalon announced that three separate trials the drug significantly reduced symptoms. The company expects to file with the FDA by the end of the year to make ADHD an approved use for Provigil.

DELICATE DANCE

IN THE MEANTIME, Cephalon on several occasions has paid Dr. Fletcher B. Taylor, a physician in Tacoma, Wash., to meet with small groups of doctors to give talks on Provigil. Taylor did an early study on his own looking at the use of Provigil in ADHD, and got positive results. He says he does not promote the use of Provigil in ADHD in his talks, but he answers questions—as he is permitted to do—if one of the doctors in the group brings it up. “Usually people ask,” Taylor says. Cephalon says it never instructs doctors on what to say at such meetings.

There are other forums to get the word out on Provigil. Doctors attend sessions called “continuing medical education” aimed at providing them with the latest information on certain diseases and treatments. These CMEs are often paid for by drug manufacturers and run by independent companies that select the speakers and curriculum without the input of the drugmaker. Still, by funding CMEs on certain topics, drugmakers have a good shot at reaching news on their products to a broad audience.

Cephalon has funded CMEs that touch on unapproved uses for Provigil. One recent program focused on treating exces-

sive daytime sleepiness in patients with Parkinson’s disease. Given the limited options for treating that sleepiness, the program detailed how Provigil might be a useful therapy. The sponsor of the program, a firm called Projects in Knowledge Inc., said that Cephalon paid for the program but had no input on the material discussed.

If Cephalon investors are concerned about the Justice Dept. probe into the company’s marketing, they have an even bigger worry. In mid-2006, analysts expect generic versions of Provigil to hit the market, despite a court battle by

Cephalon to hold such drugs at bay. It won’t be a problem in the ADHD arena: Cephalon is seeking approval for a unique dosage form, which rivals will be barred from marketing. But for all other conditions, a generic Provigil could sap Cephalon’s revenues.

That’s why Cephalon is developing a follow-on version of the drug, called Nuvigil.

Provigil is a molecule made up of two pieces, or isomers. Nuvigil is a drug based on just one of those isomers. In theory, it should last longer in the body than Provigil and may have less of an interaction with birth control pills, which Provigil can render less effective. Analysts expect Cephalon to launch Nuvigil, if it gets approved, in early 2006 and to move aggressively to switch patients away from Provigil before it goes generic.

If that works, Nuvigil may be a profitable sequel to Provigil—with the same ever-expanding list of possible uses. It’s unlikely the controversy surrounding Cephalon and its “go pill” will be laid to rest anytime soon. ■

—By Amy Barrett in Philadelphia

The drug offers hope in many areas, but it has hurdles yet to clear

PARKINSON'S DISEASE

In small studies, Provigil helped fight fatigue, a common complaint among Parkinson’s patients. Studies have shown a similar benefit with multiple sclerosis.



ADHD

Like other stimulants, it may counteract symptoms of attention deficit hyperactivity disorder. The drug doesn’t appear to treat depression, but it may offset fatigue related to the condition.

PAINE NDENCE

the drug offered users a lift, dampened the high pain—so it might relapses.



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THE SECRET WORLD OF MARSH MAC

CEO Jeff Greenberg presides over the arrogant and tight-lipped culture of Marsh & McLennan, where conflicts of interest abound. There's more trouble coming for the world's largest insurance broker.

BY MARCIA VICKERS





WHEN JEFFREY W. GREENBERG took the helm of notoriously secretive Marsh & McLennan Cos. (MMC), a \$12 billion financial-services company, on Nov. 18, 1999, analysts were happily buzzing that Greenberg was a gregarious, outgoing executive. The word on Wall Street was that he would raise the profile of Marsh Mac with more public appearances and open communication than his tightlipped predecessor, A.J.C. "Ian" Smith.

They couldn't have been more wrong. In the past four years, Greenberg sightings have been scarce. The company, true to its secretive history, became even more cloistered. But on Oct. 14, Marsh & McLennan was forced into a harsh public spotlight when New York Attorney General Eliot Spitzer charged its insurance brokerage with fraud. In a civil complaint filed in New York State Supreme Court, Spitzer alleges that the company engaged in bid-rigging, price-fixing, and accepting pay-offs from insurance companies.

Marsh & McLennan, the world's largest insurance broker, is paid millions annually to manage clients' risks and crises. Now it's having epic problems of the same nature itself. In a three-month investigation, *BusinessWeek* spoke with some 50 former and current MMC employees, insurance industry executives, and investigators—and discovered that the firm's problems may well go far beyond Spitzer's initial charges.

BusinessWeek has learned that MMC and its executives could face a raft of further legal and regulatory problems. Spitzer's office is mulling criminal charges against several execs connected with the insurance brokering scandal. It is also looking into whether Mercer, MMC's pension-consulting arm, and Putnam Investments, MMC's mutual-fund company, push clients into buying Marsh insurance products. As part of an industrywide sweep, the Securities & Exchange Commission is probing Mercer's alleged "pay to play" practices of requiring payoffs from money managers who want it to recommend them to pension clients. At the same time regulators are examining payments Putnam and other mutual-fund outfits make to companies to ensure that their funds are featured in corporate 401(k) plans.

As if that's not enough, several class actions have sprung up—at least one regarding the alleged fraud at Marsh Inc., as the insurance brokerage is known, and others involving Putnam. Already, the legal onslaught is taking a toll. On Oct. 19, Moody's Investors Service downgraded the firm's debt, citing concerns about "financial consequences" arising from Spitzer's lawsuit. And fear that some of MMC's revenue streams could dry up has knocked down its share price. In the four trading days following Spitzer's Oct. 14 announcement, the stock plummeted 48%, wiping out \$11.5 billion in market cap.

GREENBERG A slow response to problems and the culture that spawned them

At the center of the storm stands Jeff Greenberg, 53. If you ask almost anyone about him, you'll hear that he is smart as a whip, incredibly knowledgeable about the in-

MICHAEL LEWIS/CORBIS OUTLINE

» “If you eliminate all the questionable payments... you eliminate half of their profits,” says a former Marsh Mac exec

insurance business, well-spoken, and polished. Much like his father, Maurice R. “Hank” Greenberg, 79, the legendarily hard-charging chairman and CEO of insurer American International Group Inc., he has a history of being opportunistic when it comes to scoring profits for his company. Even now, his defenders insist that he inherited serious problems, particularly in the brokerage and mutual funds businesses, when he moved into the top slot.

Yet Greenberg has been slow to tackle the problems and reluctant to change the arrogant culture in which they festered. His company has a business model of aggressively cross-selling the products of its various divisions, which, say former and current employees and investigators, can lead to serious conflicts of interest. The potential for new conflicts rose as Greenberg pursued a policy of growth by acquisition. Add the tough financial goals that Greenberg sets for senior managers, and the pressure to bend the rules grows. An MMC spokeswoman disagrees: “MMC has historically served clients with a wide array of services and products. We find if we serve clients well, financial goals are met.”

The firm’s obsessive focus on secrecy helps keep any misdeeds under wraps, say the sources. “Some companies have a culture based on kickbacks and undisclosed financial arrangements, and their people are forced to remain silent about wrongdoing,” says Edward A.H. Siedle, a former Putnam compliance director and SEC official who now heads the Center for Investment Management Investigations in Ocean Ridge, Fla., which looks into pension fraud.

Why didn’t Greenberg act more promptly? Some critics say he seems deaf to the swelling chorus of demands from regulators and the public for higher standards of behavior in the financial-

SPITZER New York’s activist Attorney General is mulling new charges



services industry. In the early days of Spitzer’s investigations, Greenberg dispatched General Counsel William L. Rosoff to meet the Attorney General. Rosoff behaved like a pit bull, says one attendee, and infuriated Spitzer with condescending remarks. “The leadership of that company is not a leadership I will talk to,” Spitzer said later.

Several former top MMC honchos blame Greenberg’s executive style. They say he is an indecisive leader and somewhat detached. He is a hands-off manager—as long as his staff make their numbers. Says one employee: “It’s the kind of place where if you don’t meet or exceed a goal, heads roll.” Typically, Greenberg favors domineering division heads and gives them free-

A SEA OF TROUBLES

Marsh & McLennan's Greenberg has faced his share of tough times

NOVEMBER, 1999

Greenberg becomes CEO of MMC. In May, 2000, he becomes chairman.

SEPTEMBER 11, 2001

Nearly 300 Marsh employees are killed in the World Trade Center attacks.

OCTOBER, 2003

Enforcers charge an MMC unit, Putnam Investments, with securities fraud, alleging that managers and others engaged in late trading and market timing of its mutual funds. Later, Putnam settles and pays a \$110 million fine.



Nearly 300 employees were lost

NOVEMBER, 2003

Lawrence Lasser, an MMC director and longtime Putnam CEO, is forced to resign.

MARCH, 2004

The SEC starts investigating Mercer and other consultants for “pay to practices”—forcing investment managers to pay fees to get Mercer’s endorsement to pension funds.

MARCH, 2004

CalPERS and four other pension funds force an

BusinessWeek requested several interviews with Greenberg but was repeatedly told: "Mr. Greenberg does not speak to the press." Understandably, companies are reluctant to comment on ongoing investigations. A company spokeswoman says, "Marsh & McLennan is a company that neither condones nor tolerates wrongdoing and takes forceful action when such issues arise." The company said it has voluntarily suspended the contingent fee payments. Until the latest scandal, Greenberg and others in the industry have staunchly defended the fees. They say brokers go beyond the call of duty for their clients, by, for example, creating custom policies or collecting premiums. On a July conference call with analysts, Greenberg said: "We provide services for which we expect compensation. We don't spend a lot of time worrying about it."

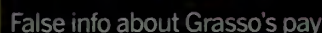
PERHAPS WILLIAM GILMAN, Marsh Global Broking's executive director of marketing and a managing director, was doing the worrying. Gilman, in his 60s, is a larger-than-life character who some call Kill Bill, after the Quentin Tarantino movies. The nickname could also have something to do with an internal AIG memo about bidding for business that was an exhibit in the Spitzer case: "Per W. Gilman—get to right number [regarding a bid] or 'we'll kill you.'" Says a former colleague: "He's the kind of guy who stubs a cigarette out in your coffee cup."

Gilman, says Spitzer's complaints, strictly enforced the system of rigged bids and payoffs from insurers. He also rated insurers by how much they paid Marsh in contingent commissions. A September, 2003, e-mail from his office released by Spitzer reads: "We need to place our business in 2004 with those that ... pay us the most." A source close to the investigation

Spitzer charges Marsh with fraud, alleging that its brokerage engaged in bid-rigging, price-fixing, and accepting payoffs from insurers. Marsh says it is conducting a thorough investigation of the allegations.

Data: ☐ No ☒ Yes

Mercer—MMC's compensation and pensions unit—admits it gave inaccurate information to the NYSE board about then-Chairman Richard Grasso's



Allstate

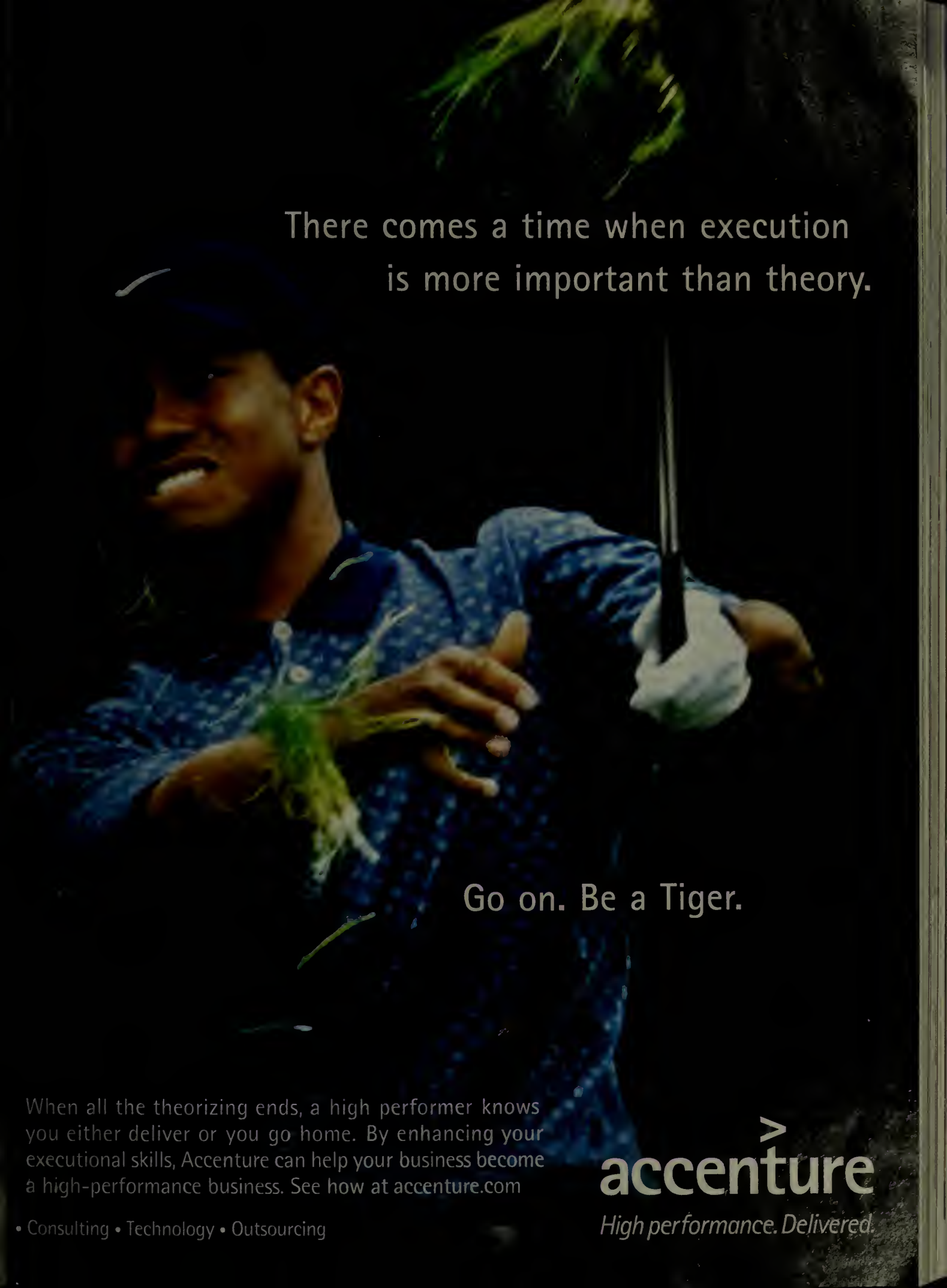
High-performance customer service, delivered.

To maintain its position as one of the country's largest property and casualty insurers—while also positioning itself to offer a broader range of financial products—Allstate wanted to offer new ways of interacting with customers, and to do it on an aggressive schedule. Building on a long relationship with Allstate, Accenture deployed eight development teams to help design and implement The Good Hands Network, which adds integrated Internet and call center channels to the existing system of local agents. Deployed in just 18 months, the two new channels enable customers to do business with Allstate 24/7. Already, over 40 percent of the company's more than 6 million yearly inquiries are made outside of traditional business hours, further extending the company's standing as a high-performance business.

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High-performance operations, delivered.

A 163-year-old brand with many owners over the years, Thomas Cook UK & Ireland was a respected but complex, decentralized travel services business in need of a return to profitability. In an innovative co-sourcing arrangement with Accenture, the company created a shared services center to consolidate its widely dispersed IT, finance and HR administration operations. Responsibility for strategy and policy was retained by Thomas Cook, with Accenture facilitating operations management. In 16 months, the company removed £140 million in operational costs, helping to achieve an £83 million turnaround, establishing Thomas Cook as a high-performance player in the competitive UK travel business.

A black and white photograph of Tiger Woods in the middle of a golf swing. He is wearing a blue patterned polo shirt and a dark cap. His hair is flying, and he has a focused expression. The background is dark and out of focus.

There comes a time when execution
is more important than theory.

Go on. Be a Tiger.

When all the theorizing ends, a high performer knows you either deliver or you go home. By enhancing your executional skills, Accenture can help your business become a high-performance business. See how at accenture.com

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» Dealing with Gilman, you learned "Billy's Rules." No. 2: Don't get stupid—never question Marsh's schemes

told *BusinessWeek* that Gilman will likely face criminal charges. Gilman did not return several calls. On Oct. 19, MMC suspended Gilman and four others.

Folks dealing with Marsh were supposed to abide by "Billy's Rules"—a playbook Gilman devised for insurers, according to someone familiar with the company. The rules were: 1) No "no's" (meaning Gilman should never be told "no" about any predetermined Marsh arrangement). 2) Don't get stupid (never question Marsh's schemes). 3) If you get stupid, we will broom your ass. 4) Never think you own your business, you only rent your business. Marsh owns your business. "Billy's Rules," emblazoned on an office plaque, hung in Gilman's office.

Gilman, according to the complaint, oversaw Marsh's "throwing-the-quote" scheme, whereby some insurers were told to quote artificially high bids for business. Several times, Gilman refused to allow AIG to relay competitive bids to clients, according to Spitzer's complaint, warning AIG that "it would lose its entire book of business with Marsh" if it didn't provide higher price quotes than the insurer Marsh favored. The phony quotes were often referred to as "throwaway quotes," "protective quotes," "backup quotes," or "B quotes," says the complaint. In return, according to Spitzer, Marsh protected AIG and other firms that played ball when it was their turn to win. AIG declined to comment.

Gilman also staged what he called "drive-bys"—in which insurers were asked to attend presentations for prospective clients even when they knew they had no chance of snagging the deal, according to Spitzer. A regional manager for Munich-American RiskPartners, a division of American Reinsurance, who was so frustrated by constant requests from Marsh for "live bodies" to attend drive-bys that he wrote in an all-caps e-mail: "We don't have the staff to attend meetings just for the sake of being a body. While you may need a live body, we need a live opportunity."

Gilman may have enjoyed such power because Marsh already dominated insurance brokering. By the late '90s, Marsh had cornered 40% of the global business thanks to aggressive acquisitions. Marsh's grip tightened when it centralized control of brokering activities in New York. Analysts say Marsh's dominance allows it to control pricing, the way insurance products are structured, and how premiums and payouts are disbursed. "They have both

their clients and insurers by the *cojones*," says a competitor.

But now it's MMC's top brass who are squirming. Being in the spotlight is highly uncomfortable for MMC—long known as a prude, white-shoe firm with an air so understated and secret that at least one former exec likened it to working at the CIA. Marsh's ranks have included Ambassador L. Paul Bremer III, former Presidential Envoy to Iraq, who recently ran MMC's crisis-consulting business; Stephen Friedman, President George W. Bush's top economic adviser and former Goldman, Sachs & Co. co-chairman, who was an MMC senior principal; Craig Stapleton, the husband of George W. Bush's cousin Dorothy, who was an MMC president; and Lord Lang of Monkton, a former British Member of Parliament who still sits on the board. Many Marsh and Putnam executives spent summer by the sea in ultra-wealthy and clubby Watch Hill, R.I.

"I'd Love to Talk...But"

MMC CERTAINLY GOES TO extraordinary lengths to ensure loyalty. A former Putnam executive recalls being grilled by company psychiatrist in a hotel room for hours during a job interview. Says the former exec: "Everyone has a Dr. [James] Terry story. He would ask questions like: 'What's the worst thing that ever happened to you?' 'What are your views on religion?' 'Who do you vote for?' They tell you they're looking for signs of malfeasance or criminality. But they're also looking for people who will fit in, lockstep, at the company." An MMC spokeswoman claims that using a psychiatrist for screening purposes is "industry practice." Terry could not be reached for comment.

Once they're in, most people who join MMC's upper echelons must sign binding noncompete agreements, say both current and former employees. "Each time you exercise stock options, you have to sign a new one," says one former exec. MMC calls this "a generally accepted practice." Employees who leave MMC and then disparage it face public risk losing any deferred compensation to which they are entitled. One former MMC exec told *BusinessWeek*: "Gee, I'd love to talk to you. There's a lot to say. But they got my money."

Since moving to rival broker Wilshire Group Holdings Ltd., a former Marsh executive says he has been spied on by a private investigator who he suspects works for Kroll Inc., which MMC bought in July for \$1.9 billion. He says he believes MMC wants to ensure that former employees are not using its proprietary information. MMC would not comment without specific details. Another former exec says MMC constantly monitored internal phone calls. MMC says it is unaware of this.

At the start of 2004, insiders say, MMC managers were forced to sign new noncompete agreements. At least two longtime MMC execs left as a result, they say. "The feeling was, I've never disparaged the company and I've been loyal all these years. And you're making me sign another one of these?" says one.

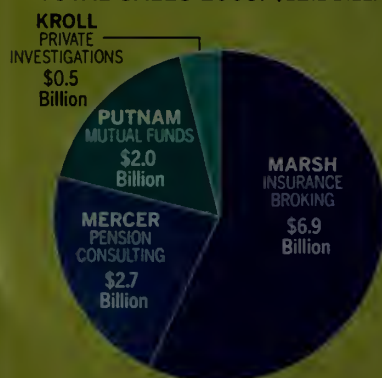
A GUSHER OF LOSS

Marsh Mac lost \$11.5 billion, or 48% of its market cap, in the four trading days after Spitzer announced an investigation of its insurance brokerage.



The hit is so bad because brokering is the lion's share of the firm's business:

TOTAL SALES 2003: \$12.1 BILLION



Data: Bloomberg Financial Markets, company reports

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The changes, say former execs, were designed to stem a rising tide of defections by its brokers to smaller rivals who they say treat clients more fairly. Over the past year, MMC has been embroiled in a nasty lawsuit with Palmer & Cay, a Savannah (Ga.) insurance broker whose president, James B. Meathe, is Marsh's former Midwest chief. In documents filed in Michigan's Wayne County Circuit Court in September, 2003, MMC alleged that P&C set out to induce some 70 "key Marsh employees to resign" and "violate their noncompete agreements" to join P&C, which P&C denied. Robert Cleary, a lawyer representing P&C declined comment. Sources familiar with the suit say Marsh has used tough tactics, with one Marsh board member telling P&C: "We're going to bury you." MMC declined comment.

Such behavior seems at odds with Greenberg's impeccable

Avenue and a weekend house in Lakeville, Conn. With his tall and muscular physique, friends say, he plays a mean game of tennis. Steven Rattner, managing principal at private investment firm Quadrangle Group LLC (page 90) who serves as Brown trustee with Greenberg, says: "Jeff's a real stand-up guy. He's thoughtful, committed, and always does what he says he's going to do." Veteran journalist Nikki Finke, who was married to Greenberg in the early 1980s, says he was never a spoiled rich kid. During high school he pumped gas and cleaned boats.

And despite the unfolding scandals, most industry players still seem to respect Greenberg. He certainly got high marks in his early days as MMC CEO for his handling of the aftermath of the September 11 World Trade Center attacks. Three years earlier

Marsh had leased floors 93 to 100 in Tower One and 294 MMC employees—mostly salesmen, secretaries, and analysts in their 20s and 30s—lost their lives after the first airplane hit. At service Greenberg spoke movingly about the makeshift memorial that had occupied an entire wall next to the cafeteria at MMC's Sixth Avenue headquarters.

A HUSH-HUSH WORLD

Marsh Mac fosters a secretive culture. Some tactics:

PHONE CALLS MMC monitors internal telephone calls, say former employees.

PRIVATE EYES Some former MMC employees say they believe they are or have been investigated by MMC to see if they're complying with noncompetes.

NONCOMPETES MMC forces employees to sign such agreements when exercising stock options. The pacts contain nondisclosure provisions: If employees later disparage the firm or spill trade secrets, they risk losing deferred comp.



After Andrew

STILL, JUST DAYS after September 11, Greenberg and top MMC execs met to figure out how to protect it from the disaster. They formed a subsidiary, Axis Specialty Ltd.—to sell insurance to corporate customers at three or four times the rates before September 11. MMC says that it was merely "meeting market demands."

For some industry players the move recalled what Greenberg did in 1992 after Hurricane Andrew slammed into South Florida and wiped out some \$15 billion worth of property. Jeff, who was working for dad at AIG, sent out an internal memo stating: "This is an opportunity to get the price increases now." It was leaked to the press, which had a field day—with one newspaper branding him "a vulture." The memo moved Ralph Nader to complain and Florida regulators to freeze rates. People close to Jeff say he was humiliated by the incident. "That's a major reason why he avoids the press these days," says one.

Greenberg's ambition has been fueled by father Hank. Says ex-wife Finke: "Jeff was always terrified of his father. He was deeply insecure and wanted his approval." "Hammerin' Hank" is known for his cantankerous, rough-and-tumble demeanor. "Hank was known for calling up his lieutenants on weekends and holidays and bawling them out," says a former executive.

When Jeff was working under his father in the early '90s, heading up AIG's domestic brokerage

group, Marsh sources say Hank raked him over the coals at a meeting in front of top executives. Hank, they say, had ordered Jeff to deal with a personnel issue, but Jeff had dragged his feet. Says one: "Hank started yelling at Jeff in front of everyone: 'You either fix your management problem, or I'll fix mine!'" But the *coup de grace* came in 1995 when Hank abruptly promoted Jeff's younger, less experienced brother Evan, making them equals in AIG's hierarchy. Two weeks later, Jeff left.

Evan, 49, is a college dropout and nonconformist who, by 1

pedigree. After graduating from upper-crust Connecticut boarding school Choate, Greenberg headed to Brown University, where he graduated with honors. He then earned a J.D. degree at Georgetown University's law school. Greenberg sits on a number of prestigious nonprofit boards, including the New York Stock Exchange. He's a trustee of the Brookings Institution and a member of the Trilateral Commission—an organization David Rockefeller founded in 1973 that consists of the world's top political and business leaders.

He and his second wife Kimberly have four children. According to friends, they lead a relatively quiet Manhattan life with little of the ostentation that often accompanies the CEO lifestyle despite the \$22 million Greenberg took home last year. The family has a spacious but understated apartment on Park

FORTRESS Marsh's obsessive focus on secrecy is instilled in its staff early and often

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Get your ideas remembered.

Get the impact you need.

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» After the scandal, Greenberg moved too slowly, says a Putnam exec, hurting the firm's reputation

own admission, had a bit of a troubled youth. But he had a knack for the insurance business and rose quickly at AIG. Unlike Jeff, Evan is one of the few people who stand up to his father. "Evan's scrappy—a yeller," says an insurance industry veteran. "I think Hank could somehow relate to him better than Jeff." But in 2000, Evan also resigned from AIG. He now heads Ace Ltd., a Bermuda company named in Spitzer's complaint—along with AIG—as one of those involved in Marsh's alleged bid-rigging and price-fixing schemes.

Months after exiting AIG, Jeff landed at Marsh & McLennan, where he had worked as a broker in the mid-'70s. As a partner in MMC Capital, the firm's risk-capital unit, he



excelled at building MMC's Trident Funds, which invested billions in various insurance entities and real estate, and hoisted himself onto the fast track. He was determined "to show up his dad and brother," says a source familiar with the family.

At Marsh Mac, Jeff was able to take advantage of the Greenberg name: Then-CEO and Chairman Smith—an old acquaintance of Hank's—was Jeff's personal mentor. Jeff was named chairman and chief executive of MMC Capital in 1996. By the beginning of 1999, he had been promoted to president of Marsh & McLennan. And by the end of that year, he was CEO. He was elected chairman in May, 2000.

Even if Greenberg did inherit the Marsh Mac mess, he's under fire for how he handled it. "Despite seeming like a hero for ousting [former Putnam CEO Lawrence J.] Lasser and moving toward cleaning up Putnam, the truth is, Greenberg didn't address things until he absolutely had to," says a former colleague. In November, 2003, after Putnam was slapped with a securities-fraud charge, longtime CEO Lasser, 61, was forced to resign. Regulators alleged that company brass had been

FAMILY PORTRAIT
Brothers Evan (left) and Jeff (right), with father Hank

aware of illegal trading in Putnam funds since 2000.

Problem was, the autocratic Lasser had already built an empire that accounted for half of MMC's revenues when Greenberg took over. "Lasser basically created his own little fiefdom and allowed no one in," says Mercer E. Bullard, president and founder of Fund Democracy, an advocacy group, and a securities law professor at the University of Mississippi. But after the 2000 market crash, some MMC execs say Greenberg should have swooped in and taken control. Says a former Putnam exec: "[Jeff's] delaying tactic cost Putnam its reputation." Insiders say Charles E. Haldeman, who took over as Putnam's CEO last November, was angry at Greenberg for dragging his feet. Haldeman declined to comment.

A Frustrating Process

IN THE PAST YEAR, PUTNAM has lost some \$70 billion in assets. Recently, several pension funds, including CalPERS, the California Public Employees' Retirement System, agreed to let Putnam compete for its business, but with stipulations: Putnam must consider pruning executive pay and ramp up financial disclosure. "That's a huge positive move for corporate governance," says Minow.

But governance gurus still aren't happy with MMC or Greenberg. The Corporate Library says the company still awards its execs excessive compensation. In 2003 it paid an aggregate \$60 million to its top five officers, vs. an average \$21 million at other large financial companies, according to Glass Lewis. MMC says: "Our independent directors and outside consultants set compensation." This past year, several large pension funds joined forces to propel an independent director, Zachary W. Carter, a lawyer, onto the board. Richard Ferlauto, director of pension and benefit policy at the American Federation of State County & Municipal Employees, says it was a slow moving and frustrating process: "Jeff thought he knew what was right, and he wasn't going to let anyone rock the boat." Carter didn't respond to numerous interview requests.

Earlier this year Greenberg asked mentor Smith, 69, to come out of retirement to help him. Insiders say Greenberg was intimidated by Lasser and needed Smith to negotiate with the former Putnam CEO. Smith, who has an office close to Greenberg's, was named chairman of Putnam. Greenberg also promoted Steven Spiegel, Lasser's right-hand man, to vice-chairman of Putnam. Says Bullard: "Although Haldeman has taken control and is doing a great job, doesn't change the fact that a lot of bad stuff happened under Smith and Spiegel."

Some of the bad stuff may have had to do with Putnam funds being pushed by Mercer, Marsh Mac's pension-consulting arm. Mercer was long considered a sleepy, less profitable outpost of the Marsh kingdom. Then, say insiders, in the mid-'90s it came under pressure to turn bigger profits. That's when it started offering pricey conferences for money managers at \$50,000 to \$60,000 a pop. "If you don't attend those, it's nearly impossible to get on Mercer's list to manage pension money," says Jack Silver, a former trustee at Chicago teachers' pension fund. MMC denies this. The SEC is investigating these allegations. And Spitzer will likely look into whether Putnam pushes Marsh-brokered variable annuities.

oducts onto investors. "There's no disclosure about this conflict to Putnam clients," says Selva Ozelli, a securities lawyer close to the investigation. There could also be an investigation into how Marsh, allegedly slow to pay out premiums, profits from the float.

That means deepening troubles for Greenberg, who some critics say has done far too little to shore up MMC's reputation over the past year. "Print it, post it, and pray—it seems as if it's all Greenberg's done when it comes to ethics," says Patrick McGurn, special counsel at Institutional Shareholder Services Inc., a corporate governance consultant. Until now,

say analysts, Greenberg's main focus has been on acquiring more companies. Now he's forced to deal with spreading legal woes and a public-relations nightmare. Says David D. Brown IV, Spitzer's investment protection chief: "We're really just at the beginning here. We're pursuing a number of leads and will follow them where they take us."

In an Oct. 15 press release Greenberg announced that MMC was appointing a private investigator to look into the alleged insurance broker fraud. It's a move some might have applauded, except for one thing: He gave the job to the head of MMC's Kroll—who's now the head of Marsh. ■

COMMENTARY

BY DIANE BRADY

A Crazy Quilt of Rules

Why insurance regs need national standards

ELIOT SPITZER HAS done it again. When he filed suit on Oct. 14 against some of the biggest players in the insurance industry, he not only alleged fraud. The New York State Attorney General also uncovered yet another massive hole in financial regulation—not to mention widespread complacency among regulators. Now another corner of the finance industry must rewrite its rules as companies renounce practices that got them into trouble

But fixing insurance regulation is far beyond Spitzer's bailiwick. The system is a mess. Washington has struggled to get a say over the industry, leaving each state to oversee insurance in its own way. That means 50 state insurance commissioners, 50 sets of laws, and 50 different sets of rates. In some states, legislators bowing to populist pressure have regulated personal insurance so tightly that few companies will do business there. In others, lawmakers have been so cowed by the commercial insurance industry's lobbying power that they have never banned such dubious practices as contingency commissions. And in some states the revolving door never stops spinning as commissioners quit to head up insurers, and vice versa.

Today's system was forged in the 19th century, when the states took the

lead in regulating everything from railroads to utilities while Washington stayed on the sidelines. These days, the patchwork regulation results in massive overlap, byzantine policies, and idiosyncratic procedures. Nevada has insisted that some documents be filed on pink paper. Wisconsin is famous for asking companies to hand-write a slash through every zero on paper forms filed with the state. New York's bureaucratic approval process can delay new insurance products by many months.

Insurers, sick of the cost and hassle of

complying with 50 state regulators, have long lobbied Washington to wrest some authority away from the states. But state commissioners, backed by their hometown members of Congress, often beat back the effort. Says Julie Rochman of the American Insurance Assn.: "While the rest of the financial-services sector has been modernized, insurance has been left behind."

What's needed is a streamlined set of national standards. That would cut costs for insurers and their customers and free up state authorities to focus on issues that matter: protecting consumers from fraud, and making sure insurers are financially sound and obey the law.

A new congressional bill dubbed SMART, for State Modernization & Regulatory Transparency, might achieve this. Crafted by Representative Richard Baker (R-La.), the proposal would require states to adopt common standards, accelerate the process for getting products to market, and end state approvals of premium rates. There wouldn't be a national regulator, but SMART calls for a seven-person board of state and federal officials to

help arbitrate disputes among insurers and regulators and to address thorny regulatory issues. "Our goal is a system that enhances competition and accountability," says Baker.

Some argue that the status quo is fine. Says California Insurance Commissioner John Garamendi: "The more regulators you have, the better the opportunity to find a problem." Maybe so, but it took an outsider—Spitzer—to get action. It's time to stop

saddling a global industry with a regulatory system dating back to the era of the iron horse. ■

—With Amy Borrus in Washington



BOTH SIDES, NOW Baker's bill would establish a state-federal board

Quadrangle's Connections

Steve Rattner and his partners are staking out positions across the media landscape

STEVEN RATTNER LEFT Lazard Frères & Co. in 2000 for the same reasons that scads of Wall Streeters lately have deserted big investment banks to form their own private-equity funds. Money. Freedom. More money. In addition, Rattner, who was hailed a decade ago as "the most-talked-about investment banker of his generation," wanted to climb down from his star's perch and vanish into the all-for-one, one-for-all collectivity of a true partnership. Rattner, now 52, could have started Rattner & Co. but instead joined with three Lazard colleagues to found Quadrangle Group LLC.

After a purposefully slow start, Quadrangle has made up for lost time of late, sinking a total \$825 million into nearly 20 companies. A handful of these investments have been cashed out, most notably a \$75 million investment in Cablevision Systems Corp. that returned a 100% profit in just 11 months. It will be years before the final returns on the rest are tallied, but at the moment the winners in Quadrangle's portfolio clearly outnumber the losers. Although the firm mainly invests in midsize media and telecom companies, other investors periodically invite Quadrangle into their megadeals. For example, *BusinessWeek* has learned that members of the Sony Corp.-led consortium that is paying \$3 billion for Metro-Goldwyn-Mayer Inc. are trimming their equity investments by \$50 million to allow Quadrangle to buy in.

"In a multibillion-dollar deal, the amount of money Quadrangle can put in is not that useful," says Thomas H. Lee, founder of Thomas H. Lee Partners,

which has two investments in common with Quadrangle. "But they understand their industries so well that Quadrangle has become a preferred partner to other private-equity firms."

Not everyone is enamored of Quadrangle. Its quick sale of what was supposed to be a long-term investment in Cablevision stock antagonized Chairman Charles F. Dolan, all the more so because he had made room for Rattner on the company's board. In Rattner's defense, Cablevision abruptly shifted its strategy not long after Quadrangle bought in. There also is bad blood between Lazard Frères and Quadrangle, which in 2002 hired all three managers of a distressed-debt fund that Lazard had just set up. Lazard sued and the Quadrangle partners countersued, initiating a bitter legal battle that still drags on.

The knock against Rattner during his investment banking days was always that he was too calculating in his ambition and too eager to use his insider's knowledge of publicity to personal advantage. A flattering profile of Rattner in

Quadrangle Group

ORIGINS Founded in 2000 by four former partners of Lazard Frères, led by Steven Rattner, one of Wall Street's best known deal advisers.

PURPOSE Private equity investments in media and communications companies. Also invests in the debt securities of troubled companies.

FINANCES The firm has invested \$825 million of a \$1 billion private equity fund raised in 2000; also runs \$1.1 billion in three distressed debt funds.

OUTLOOK Thriving for now, but could be badly hurt if Rattner takes a job in a John Kerry Administration.

LAZARD GRADS
Rattner, center,
with partners
Tanner, Ezersky,
Steiner, and Huber

Vanity Fair in 1994 so enraged Felix Rohatyn, Lazard's legendary senior partner that he nearly fired his protégé. Rattner still writes the occasional guest op-ed piece and is frequently quoted in articles about Wall Street and the media business

but he has shunned personal publicity for years now. "It's probably true that at parties Steve spent too much time with all the right people and no one else," says a close friend. "But to build a company, you have to subordinate your ego. Steve's done that and he seems comfortable now in his own skin."

By all accounts, Quadrangle is an unusually democratic and collaborative sort of firm. "Steve made a decision early on that he wanted to





of a genuine partnership, and he has carried out that promise to us," says partner David Tanner. However, Rattner and founders Tanner, 45, Peter Ezersky, 43, and Joshua Steiner, 39, are not exactly the *Three Musketeers* of private equity. Rattner owns a larger share of Quadrangle than any other partner and is clearly regarded by outsiders as preeminent in stature, if not in rank. (The partners all share the title of managing principal.)

THE KERRY CONTINGENCY

WHAT'S MORE, Rattner's promise might all carry a Nov. 3 expiration date. "The question is, if Kerry wins, what does it mean for Steve?" says Arthur O. Sulzberger Jr., a longtime friend of Rattner's, who is chairman of New York Times Co. and a limited partner in Quadrangle. Rattner, an activist Democrat from New York, signed on with John Kerry

during the primaries and was instrumental not only in raising large sums for the candidate but also in persuading 200 CEOs and other business leaders to declare their support. (Rattner's wife, Maureen White, is a finance chair of the Democratic National Committee.) If Kerry wins, Rattner is expected to be offered a job in the new Administration. "If Steve goes to Washington, can Quadrangle still be a force?" asks a dealmaker with close ties to the firm. "I can tell you that's not a happy topic over there."

If Rattner stays put, Quadrangle's big challenge becomes managing its growth. Its partners, who now number eight, are trying to fashion a more centralized and formal management structure without turning Quadrangle into a *de facto* Rattner & Co. in the process. Rattner himself is acutely aware of the dilemma. "When you have four partners, you make

decisions one way. When you have eight, you have to make them another way," he says. "We don't know exactly what form a new structure will take, but I am determined not to have a personality cult."

Rattner is an unlikely Wall Street star in some ways. He never went to business school but got his start as a journalist, spending seven years as a *New York Times* reporter before landing an entry-level investment banking job in 1982 at the untender age of 30. Rattner made up for lost time, joining Morgan Stanley in 1984 as one of the first mergers-and-acquisitions bankers to specialize in media. This fortuitous assignment put him on the ground floor of cable TV and other emerging industries. He left Morgan in 1989 and burnished his media maven credentials to a high gloss at Lazard.

Rattner is not the incandescent sort of personality who lights up a boardroom

merely by walking into it. However, he is a man of quiet intellect who listens as well as he talks and who has spent three decades cultivating relationships with people who matter. None of them has mattered more than Brian L. Roberts, CEO of Comcast Corp., the largest U.S. cable operator. Roberts met Rattner in 1985 and has included him in every major deal Comcast has done since. "Steve is a very smart guy," Roberts says. "He has followed this business for a long time and always gives you his best advice, even if it doesn't serve his own short-term interests."

Rattner began to recast himself as a lower-profile manager in 1997, moving up to deputy CEO at Lazard. He lasted two years, an eternity at the famously divisive superboutique. Rattner, Ezersky, Steiner, and Tanner spent months methodically planning their breakaway venture, meeting after hours in Rattner's Fifth Avenue apartment. Quadrangle was launched in February, 2000, and quickly raised \$1 billion from 150 investors, nearly half of whom are current or former top executives of media or telecom companies. "What sets Quadrangle apart is they are really in the thick of what's happening in their area of functional expertise," says Russell Steenberg, who runs Merrill Lynch & Co.'s private-equity unit, a Quadrangle investor. "They have the contacts; they hear the tom-toms."

MATCHMAKING

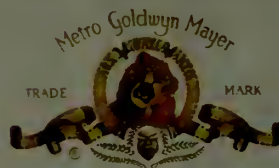
QUADRANGLE'S CONNECTIONS have helped it in countless ways, but the most visible payoff is its inclusion in "club deals" organized by bigger, more established players. Quadrangle had close ties to all three of the lead investors in the MGM deal—Sony, Texas Pacific Group, and Providence Equity Partners—and

was particularly helpful in smoothing Comcast's deal-clinching, last-minute entry into the consortium. Last year, Quadrangle played a similarly catalytic role in helping the Hollywood billionaire Haim Saban pull together his \$1.2 billion buyout of German TV broadcaster ProSiebenSat.1.

In both the MGM and ProSieben transactions, Rattner and his partners filled the same middleman role that they played at Lazard, only they were rewarded not with fees but with a chance to purchase equity. The ProSieben buyout already is casting a golden glow, but earning its way into high-profile club deals is a sideline for Quadrangle. "It's nice to have extra frosting," Rattner says, "but we are baking our own cake."

That is, Rattner and his partners spend most of their time scouring the less glamorous precincts of the media and communications world for opportunities of their own. They are hard-nosed value investors who, for all their high-powered connections, place primary emphasis on a thorough analysis of the fundamentals. Quadrangle's mettle was tested immediately, for the firm's birth coincided with the peak of high-tech mania.

Josh Steiner and Michael Huber, Quadrangle's telecom specialists, rejected dozens of potential deals before deciding to concentrate their value hunt on the fledgling regional carriers known as competitive local exchange carriers, or CLECs. (Huber, 35, was promoted to partner at the start of this year.) Over a span of two years, the duo met with executives of 45 companies in the struggling sector. In 2003, Quadrangle sank about \$50 mil-



Quadrangle's insider status wins it entry into major media deals

lion into two CLECs: US LEC Corp. and what is now NuVox Communication. "Unlike a lot of people in the investment world, Josh in particular did a great job in understanding our industry," says Aaron D. Covell, US LEC's CEO.

Unlike most private-equity firms of its moderate size, Quadrangle also invests in the debt securities of troubled companies. Its distressed-debt unit is run by the three partners whose departure so up-

Lazard Frères: Michael Weinstock, 41, and Chris Sattana, 31. At Quadrangle, they manage a \$900 million hedge fund and two less funds of about \$65 million apiece. Quadrangle's distressed-debt operation is on a roll, racking up a double-digit gain to date in 2004 on the heels of a 45% return to investors last year.

Quadrangle's private-equity and distressed-debt funds have simultaneously invested in a half dozen of the same companies, including US LEC, Adelphia Communications, and Protection One, an operator of alarm systems for homes and businesses. The collaboration on Protection One was especially significant in that Quadrangle succeeded in taking control of the overleveraged company, paying \$122 million to acquire its senior bank debt and 87% of its stock. The private-equity fund put up \$82 million and the distressed debt kicked in the rest.

The Quadrangle partners meet every Monday, with Rattner calling out the agenda in his role as "coordinator." They bring more coherence to daily management of a firm that now has 44 employees; the partners are thinking of creating a three-person executive committee. Even if he were to remain at Quadrangle, Rattner would not necessarily be on it. "Steve is an important voice, but this is a true partnership," Ezersky says.

Quadrangle still has plenty of money to invest, but the five-year investment period of its inaugural private-equity fund expires next May. Had this not been a presidential election year, Quadrangle might likely have begun to raise a second fund already. The partners decline comment on their plans, but the only alternative to fund-raising is to wind down the firm. One thing is certain: Raising another \$1 billion will be a lot easier without him. ■

—By Anthony Bianco in New York

A Peek Inside Quadrangle's Portfolio

COMPANY	BUSINESS	APPROXIMATE INVESTMENT (IN MILLIONS)
Protection One	Operates alarm systems	\$122*
ProSiebenSat.1	TV broadcaster in Germany	\$65
MGM	Film and TV production	\$50
US LEC	Regional telecom carrier	\$30
Pathfire	Provides digital media services to broadcasters	\$25
Dalleen Technologies	Supplies billing software to telecoms	\$20
Publishing Group of America	Publishes magazine inserts for rural newspapers	\$20

*Includes \$40 million invested by Quadrangle's distressed-debt fund

Data: BusinessWeek, Bloomberg Financial Markets

FIERCE RIVALS

A close play in the ALCS



How the Commish Calls It

Bud Selig on money in the majors, steroids, and a certain rich New York team

IN THE MIDST OF a thrilling postseason, Major League Baseball Commissioner Bud Selig took time out to talk with Sports Biz contributing Editor Mark Hyman about everything from satellite radio to profits, steroids, and the Yankees-Red Sox rivalry.

Major League Baseball's just-announced, \$650 million (over 11 years) deal with XM Satellite Radio:

The deal is significant because we're going to [roughly] \$65 million a year from a zero base. That alone is remarkable.

How many franchises will be profitable this season:

I'm hopeful it's going to be half.... In the last five years there were times when only two or three teams showed a profit. It was a very, very serious situation, and a lot of people were concerned, including our bankers.

On the recent death of former National League MVP Ken Caminiti, who admitted to steroid use:

I have a great sense of sadness about [Caminiti's] death. One worry I have is that 10 years from now, long after I'm done as commissioner, someone will say: "You people knew about this and didn't do anything about it." [Caminiti] didn't deny he took steroids, and he claimed 50% of players were using. [But] he's my only source about that.

On the importance of being a Friend of Bud when bidding for a team:

A lot of franchises have been bought and sold to people I didn't know.... On the other hand, if you know people and they have a great track record in the sport, of course that helps. All things being equal, you bet it's a help.

On whether moving the Expos to Washington is the end of franchise relocation:

I think it's the end. Let me amend that: We may have another relocation. You never want to say never. But I don't see any now. Clubs are not lining up.

On criticism of the commish:

There hasn't been a lot lately. The critics seem to have gone underground. Our sport is like a dinosaur, slow to move and resistant to change. Ten or 11 years ago, I thought it was quite unfair to read comments about the wild card and later interleague play. You would have thought I defiled motherhood. Now [wild-card entries] the Red Sox and the Astros play in the postseason, and the fans love it.

On what he would have done if he had caught Barry Bonds's 700th home run ball, which is attracting bids of more than a half-million dollars in an online auction:

Given it to him. It would mean a lot more to Barry Bonds than to me as a fan. In an ethical sense, the guy who hit it, and worked to hit it, should get it. If I gave it to him, I might get an autographed bat.

On fans who are tired of seeing the Yankees in postseason play:

There's more parity than there has been in a long time. The Yankees haven't been world champions since 2000. We're seeing other teams. That will continue. We're completing the second year of our labor deal [intended to improve parity]. Revenue sharing has gone from nothing to \$270 million to, next year, \$300 million. Time will show that we're continuing to deal with disparity.

On the Yankees-Red Sox rivalry:

You can talk about the Packers and Bears, the old days of the Celtics and Lakers, the Dodgers and Giants. Those

have great histories. But the intensity of the fans in both New York and Boston is unbelievable. At the ballpark...you see people praying. There can't be another rivalry this intense.

On the number of seats MLB could sell to a World Series Game 7 matching the Yankees and Houston Astros, with Roger Clemens pitching:

I'd say you could fill the Grand Canyon. ■



SELIG He wonders where his critics went



JAROMIR JAGR
At \$11 million, the
Rangers star is the
NHL's top earner

An Entire Season in The Penalty Box?

With players and owners not even talking the NHL looks set for a long freezeout

ON OCT. 30, COLUMBUS Blue Jackets center Todd Marchant should be skating against the Dallas Stars at a packed American Airlines Center in Big D. It should be the Jackets' ninth contest of the young National Hockey League season.

Instead the Jackets have yet to suit up, and Marchant, a nine-goal scorer last season, is at home in Ohio coaching his 6-year-old daughter's hockey team. In a year when Zamboni sightings may be as rare as the footprints of the Abominable Snowman, it could be Marchant's only ice

time. "No one likes losing money, but this year everyone involved in hockey may be losing something," he says.

Around the NHL signs are ominous. The league office has slashed 100 jobs, belt-tightening being repeated by many franchises. Players are fleeing to skate for teams from France to the Czech Republic. As incredible as it seems for a league that sells 90% of available tickets and last season generated revenues of \$2.1 billion, the NHL may sit this season out.

For five years, NHL Commissioner Gary Bettman has been warning that despite healthy growth, the league was choking under the strain of player

salaries. Last season they gobbled up nearly 75% of NHL revenues, vs. 64% for the NFL and 59% for the NBA. Losses for the 30 franchises over the past two years topped \$500 million, according to Bettman.

HARD CAP, PLEASE

"SINCE 1999, I HAVE been asking and begging the union to acknowledge our problems and deal with them," says Bettman. On Sept. 15, when the labor deal expired, he made good on a promise, shutting down the league before training camps opened.

Bettman says the lockout will last as long as it takes to win "cost certainty." And NHL owners, who claim they will lose less canceling the season than playing under the old contract, seem to be on board. "We all recognize that we have to correct this problem," says Boston Bruins owner Jeremy Jacobs.

The owners want a hard cap, similar to salary restraints in pro football and basketball, that would hold player pay to 53% of NHL revenues. Such limits would cut the average salary this year by \$500,000 to \$1.3 million. Worse, say the players, the days of profligate owners waving checkbooks at hot players—which is how they got themselves in this mess—would be over. "We're not going to play under a salary cap. We're dead-set against it," says Brad Lukowich, a veteran defenseman for Tampa Bay and Dallas.

Tough talk from the players isn't surprising given the bruising history of NHL collective bargaining. But it has been a decade since labor discord cost the league a game. In 1994, when the owners last tried to ram through a salary cap, they got body-checked. With Bettman leading the charge, a 103-day lockout canceled nearly half the season. The deal that got the season restarted didn't include a cap. The terms—entry-level salary cap and modified free agency—that Bettman counted on to tamp down salary growth quickly were evaded by owners and agents.

Bettman concedes that the league erred in 1995 by settling for less than a system linking salaries to league revenues. It won't happen again, says NHL Chief Legal Officer William Daly, adding "If it makes sense to wait until next year [to resume play], we'll wait."

One reason talks with the National Hockey League Players' Assn. are stalled is that there haven't been any lately. The sides last met on Sept. 9. When owners and player reps do get together, mostly they belittle each other's financial assumptions. Case in point: former Secur

es & Exchange Commission Chairman
Arthur Levitt Jr.'s 2004 audit of league
books, which offered the gloomy assess-
ment that 19 of 30 NHL franchises lost
money. Misleading, claims the players
union. Its analysis concludes that 75% of
the losses were rung up by six clubs. "We
have serious issues with their numbers,"
says union chief Bob Goodenow.
Who blinks first will depend on
power and finances. And the two sides
seem to have of plenty of both stored up.

Marchant says his comrades have been
preparing for years. "My wife and I sat
down one night, wrote down what we
spend our money on, and made some ad-
justments," says Marchant, who before
last season signed a five-year, \$19 million
contract. Some 243 NHL players will
barely feel the pinch of a canceled sea-
son—they're earning salaries near their
NHL pay playing overseas.

Thanks to deep-pocketed owners—
such as Cablevision Systems (New York

Rangers), Comcast Spectacor (Philadel-
phia Flyers), and Philip F. Anschutz (Los
Angeles Kings)—and a \$300 million lock-
out fund, the league has substantial re-
serves of its own. But Brad Lukowich isn't
impressed. "They could have \$300 mil-
lion or a billion, it doesn't matter. We
won't budge on a salary cap," says the
player. That kind of talk makes it seem like
the Stanley Cup finals may be an even
tougher ticket than usual this season. ■

—By Mark Hyman

VIEW FROM THE STANDS

How This Diehard Fan Would Fix Hockey

I was chatting with a friend of mine the
other day, a guy who is a big sports
fan, and I brought up the National
Hockey League lockout. His response:
"There's an NHL lockout?" He's not
the only one in the dark. The sad truth of the
lockout is that for the vast majority of
American sports enthusiasts, it doesn't
much matter. The NHL may well lose the
entire 2004-05 season, and most sports
fans in this country won't even notice.

I'm the exception. I love hockey. I've
played the sport since I was 7. At 40, I still
make time to play in two recreational
leagues. And I'm lucky enough to have two
sons who love hockey as well, so I get to
coach their teams.

That's why the lockout drives me nuts. It
couldn't come at a worse time, now that
hockey's cachet is diminishing, overwhelmed
by far better marketed sports such as
NASCAR, professional golf, and even events
such as the X Games. What better way to
alienate an already shrinking fan base than
calling off the season? You think fans in new
markets such as Nashville and Raleigh,
N.C.—where the league has already been
struggling to build support—will come back
after the lockout? "The longer this goes on,
the less relevant teams are going to be in
marginal markets," says Tod Leiweke, former
president of the NHL's Minnesota Wild and
now CEO of the NFL's Seattle Seahawks. And
yet neither NHL Commissioner Gary
Bettman nor Players' Assn. Executive
Director Bob Goodenow seem to feel much
urgency to save the game I love.

So here's my solution—an overly
ambitious attempt to address some
problems and salvage the sport. The

biggest sticking point is the owners'
insistence on a salary cap and the players'
determination not to accept one. There's no
easy solution, but I'm partial to an idea
offered by former Vancouver Canucks
General Manager Brian Burke. He proposes
a team payroll threshold of \$38 million and
a payroll minimum of \$33 million. (Last
season, team payrolls ranged from \$23
million for the Nashville Predators to \$78
million for the Detroit Red Wings.) Then, for
teams that top the threshold, he'd set a tax
stiff enough that most teams would think
twice. Burke's proposal would begin to give
owners the "cost certainty" they're after,
while not tying players' salaries to a formula
linked to the owners' financial reporting,
which they don't trust.

But the league and the players shouldn't
stop at reaching a collective bargaining
agreement. Even before the lockout, the
game was struggling to retain its fan base
and win over converts. The negotiations,
whenever they resume, give the league and
the players an opportunity to address the
issues that have plagued the game in recent
years. "As bleak as times
are now, there is an
opportunity to be creative,"
Burke says.

One problem is that NHL
hockey has become a
plodding game. The
league's rapid expansion in
the last decade has flooded
the game with players who
can't skate with the stars.
At the same time, the
players have gotten bigger,
and so have their pads. The

combination has created a game where
coaches get lesser players to clog up the so-
called neutral zone in the center of the ice.
The idea is to run enough obstruction to
neutralize elite players. But it's boring.

It doesn't have to be that way. Think
about the Olympics. They offer the most
exciting hockey there is, drawing fans and
nonfans alike. That's because Olympic
contests are played on a wider ice rink that
opens up the game and gives the elite
players space to be creative. The NHL
should adopt Olympic-sized rinks. Owners
might fret about lost revenue from the high-
priced rinkside seats that would disappear.
But I bet they'd win new fans with a more
exciting game. They could also adopt
stronger rules to curb the neutral-zone trap.

Of course, the Olympics benefit from
featuring only the game's best players. It's a
lesson the NHL should learn. The league
watered down its talent expanding to seven
new markets in the last 10 years. What's
more, many of those teams account for the
losses that owners now cite as a reason for
demanding cost certainty. It's time for the
league to recognize its mistake. It should cut
the number of teams by at least six.

But the key change the NHL should make
is to stop trying to be something it's not. The
league has developed a bad case of NBA
envy: It wants to appeal to every corner of
the U.S. That's why it expanded so rapidly.
And that's why it keeps looking for gimmicks
like the proposal to end tied games with a

shootout, which reduces
the outcome to a single
offensive skill. It's a
cheap stunt meant to
appeal to fans in new
hockey markets.

So Mr. Bettman, Mr.
Goodenow, please get
back to the bargaining
table and fix my favorite
sport. You have less time
than you think.

—By Jay Greene
in Seattle

THE STAT

6

The minimum
number of teams
the NHL should cut
to repair the league



Spiffing Up Men's Wearhouse

With competition heating up, George Zimmer has some new tricks up his sleeve

WHEN GEORGE A. Zimmer, CEO of Men's Wearhouse Inc., was pitching his company to investors before its 1992 initial public offering, he showed a picture of a man in a dentist's chair. His point: Most men consider suit shopping about as enjoyable as root canal.

From the day Zimmer founded his retail chain in 1973, he has striven to offer an alternative to stuffy department stores and chichi boutiques—a comforting set-

ting where buying men's clothes is painless and maybe a little fun, too. The bearded, gravel-voiced Zimmer even stars in his own ads, because he believes his everyman persona calms shoppers. "I have more credibility than a hired actor," he says with the same conviction he uses to spout his trademark line, "You're going to like the way you look. I guarantee it."

Zimmer may sell staid corporate wear, but his formula for guaranteeing his company's longevity is anything but conventional. To hold down costs, Zimmer, 55, locates Men's Wearhouse in outdoor shopping plazas rather than malls, and he

shuns splashy flagship stores in high-rent neighborhoods. He recently cut expense by moving the manufacturing of one line of suits from Italy to Korea. That frugal approach allows him to sell suits for between \$250 and \$300—about half the price specialty-store competitor Jos. Bank Clothiers Inc. charges for comparable suits. The neatly displayed clothes in Zimmer's stores are designed to cater to the unpretentious guy who wants to do as little as possible to maintain his wardrobe. One of the chain's most popular items is a \$50 dress shirt that doesn't wrinkle and has unbreakable buttons.

Zimmer's bargain-basement approach is racking up some impressive results. So far this year, profits at the Houston-based company have jumped 48%, to \$33.3 million. Same-store sales are up 8.2% in the U.S., coming off a 6.1% growth pace in 2003, when sales totaled \$1.4 billion. The company's stock now trades around \$30.50, up 22% year to date and far outperforming the 6% increase in a Standard & Poor's index of 25 apparel retailers.

Still, Zimmer knows he has to think beyond suits if he's to keep customers coming through his doors. With 508 Men's Wearhouse stores in the U.S. and 114 in Canada, where they're called Moore

thing for Men, the company is persistently close to saturating the market. And Jos. A. Bank and smaller competitors are quickly encroaching on Zimmer's territory. So the entrepreneur is continually looking for ways to broaden Men's Wearhouse's potential audience.

Zimmer's latest idea is to diversify beyond sport coats and ties to puffed skirts and lace veils. Late this year, he'll test two bridal shops, locating them adjacent to Men's Wearhouse stores, in Northern California. Zimmer hopes to capitalize on his tuxedo-rental business, which he launched in 1999. The unit is on track to post \$80 million in revenue this year, up from \$51.5 million last year.

A bridal business will present entirely new challenges for Zimmer, though. He'll have to offer higher levels of service than is used to, catering to finicky women who often demand multiple alterations. The infrastructure and staffing that are required are so daunting that most retailers have dodged the bridal market altogether. Zimmer, who works out of Men's Wearhouse's Fremont (Calif.) offices, figures that since he already rents tuxedos for 100,000 weddings a year, it's not too much of a stretch to try to outfit brides. Behind the scenes, Zimmer stretches the boundaries of traditional management practices, especially when it comes to managing people. He's adamant that happy employees attract loyal customers. Unlike most retailers, Men's Wearhouse doesn't perform drug tests or criminal background checks on job candidates. Every five years, all full-timers receive a three-week paid sabbatical on top of their regular vacations—virtually unheard of in the retail industry.

TTLING SUITS

ZIMMER, WHOSE 8.7% stake in Men's Wearhouse is now worth \$94 million, changed the company's stock ownership program to reduce inequities. Today, most employees get some stock. And the average store manager, who earns \$10,000 a year, gets the same number of shares from the company as higher-paid managers do. "It sounds corny, but it breeds loyalty," says independent retail analyst Janet Kloppenburg. Indeed, turnover among store managers is only about 10% annually, according to the company—far below the industry average of 25.1%.

That's not to say Men's Wearhouse has been free of labor disputes. In California, some tailors and store managers at K&G Fashion Superstore—a low-priced clothing chain owned by Men's Wearhouse—

filed lawsuits alleging they weren't properly paid overtime, among other issues. The company settled those suits but is still fighting similar charges brought by a group of Men's Wearhouse store managers. Zimmer declined to comment, citing pending litigation.

The labor unrest is a rare black mark for Zimmer, who has always been obsessed with the human relations side of management. A few years after he graduated with an economics degree from

or joke in public. He's so determined to have face time with the rank and file that he attends more than 20 Men's Wearhouse holiday parties all over the country every year. A recovering alcoholic, Zimmer resists the temptation to imbibe by gleefully dancing the night away with employees. And after 18 years of appearing in his ads, he still smiles proudly when strangers recognize him on the street. "After all these years," he says, "I'm an institution unto myself."

George A. Zimmer

Conservative fashions, maybe, but not your buttoned-down CEO:



BORN Nov. 21, 1948, New York

EDUCATION BA, economics, Washington University in St. Louis, 1970.

CURRENT POSITION

Chairman and CEO, Men's Wearhouse Inc.

CAREER PATH Worked as a substitute high school teacher before going into business with his dad, a clothing manufacturer, in the early 1970s. Started as a purchasing agent in Hong Kong, then worked as a traveling salesman. Struck out on his own in 1973, opening his first Men's Wearhouse store in Houston. Today the chain has more than

620 stores in the U.S. and Canada.

FAMILY Married to second wife Lorri; four children ranging in age from 2 to 21.

OFF HOURS Board member of the Institute of Noetic Sciences, a nonprofit that researches "consciousness, human potential, and personal and social transformation."

FASHION FAUX PAS Donned a suit for his first college date, eliciting stares and snickers from other students. Lesson learned: "There's a time and a place to wear a suit. A date during freshman orientation is not one of those occasions."

Washington University in St. Louis in 1970, he went to work for his father, an apparel manufacturer in Dallas. Zimmer started as a purchasing agent in Hong Kong, then worked in the U.S., selling clothes out of a Buick Electra. One of Zimmer's customers once asked him to take back some unsold goods and promised to place a large order to compensate. Zimmer's father balked, but Zimmer took the return anyway, believing it was important to maintain the customer's loyalty.

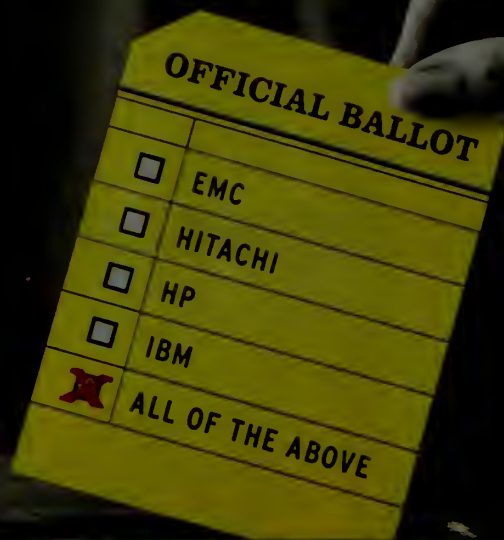
That disagreement motivated Zimmer to strike out on his own. "George always took strong positions on things he felt deeply about," says his father, Robert. Dad was a good sport, though, investing \$300,000 to help his son open the first Men's Wearhouse in Houston and later joining the company's board of directors.

Zimmer has never been the typical buttoned-down executive. Brash and comical, the CEO isn't afraid to tell an off-col-

He still has some surprises up his sleeve, too. Early this year, eyebrows shot up all over the company when Zimmer proposed appointing Deepak Chopra to the board of directors. Chopra writes books and gives seminars on spirituality and alternative medicine—two of Zimmer's passions—but some executives wondered what value he would bring to the company. Zimmer argued that he would contribute ideas on social responsibility and team-building. Shareholders elected Chopra this summer—another victory for Zimmer's out-of-the-box ideas. "This is not some New Age flighty business model with false nobility and no sustainable earnings," Zimmer says. Indeed, if he has proven anything, it's that in retail, one size doesn't always fit all. ■

—By Louise Lee in Fremont, Calif.

BusinessWeek online For an interview with Men's Wearhouse's CEO George Zimmer, go to businessweek.com/magazine/extra.htm



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STORAGE

CREATING TRUSTED DATA SOLUTIONS

The ability to efficiently and cost-effectively store, protect, and retrieve corporate information has become critical to many companies' ability to operate.



2 0 0 4

Think Sarbanes-Oxley, HIPAA, security, disaster recovery, corporate governance initiatives, and a host of financial industry regulations—every issue requires enterprises to carefully manage, preserve, and access critical data.

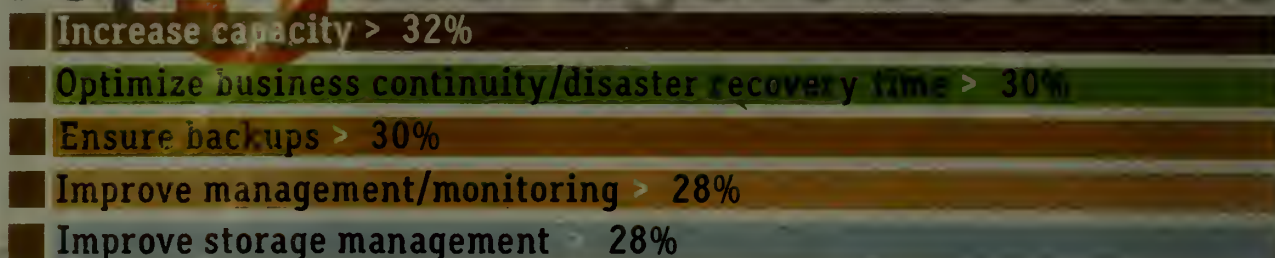
Then consider the fines and the legal exposure that companies face when records cannot be produced in a timely fashion or data privacy is compromised. From every angle, the centerpiece of successful business is corporate data.

Yet storing and protecting data is becoming increasingly challenging. The amount of data that must be stored is growing astronomically—by some estimates, by as much as 40% to 60% annually in each organization. Of course, just having the data is not enough. It has to be accessible: When

employees need a piece of data, they want it to appear on their desktop within seconds. It must be manageable: IT administrators need to store data on devices that match the business need in terms of cost and availability. And it must be affordable: Budget-conscious executives have to struggle to keep storage-related spending from going through the roof.

"Interest in storage issues is definitely rising," agrees Sheila Childs, chairman of the San Francisco-based Storage Networking Industry Association (SNIA), a vendor-neutral organization established to address the adoption of storage networks "as complete and trusted solutions." "Because data volumes are growing so fast, there is a greater challenge for companies that

Top 5 Storage Concerns



CORPORATE TECHNOLOGIES: DATA STORAGE OUTLOOK, 200

want to manage their storage, keep costs in line, and protect the enterprise from associated risk."

Storage issues, formerly a technology decision made by IT departments, are now being influenced by business decision makers, up to the executive level. Not surprisingly, technologists and executives have differing approaches—which can breed conflict in creating a cross-enterprise storage strategy. For example, in a recent in-depth survey of 49 senior IT decision makers conducted by Corporate Technologies Inc. (see last page), the majority of respondents said that increasing storage capacity is one of their top concerns. Yet the report also reveals that most companies have no plans to increase their storage staffing to accommodate this increased capacity. "There is a big disconnect there," acknowledges Peter Baer Galvin, chief technology officer for Corporate Technologies, an IT infrastructure provider headquartered in Burlington, Mass. "Often company spending plans do not sync up with the realities of their storage requirements."

Although both the IT department and executives have a stake in enterprise storage, their goals may be different. "C-level people are concerned about compliance and governance as well as business continuance and operational risk," explains Hu Yoshida, chief technology officer of Hitachi Data Systems Corp., in Santa Clara, Calif. "They are looking for the operational efficiencies that will enable their storage systems to respond quickly to user demand, within an acceptable cost range. But IT people are interested in the housekeeping issues, everything that helps

them do a better job of managing the company's storage resources. Their priorities are things like interoperability, capacity, and management capabilities."

The complexity of creating a unified storage strategy grows with the number of architectures (for instance, storage area networks versus network-attached storage), connection technologies (Fibre Channel versus IP storage), types of media (disk versus tape), and vendors. "There are so many storage methods, components, and requirements," says Steve Solomon, senior vice president and general manager of the recording media division for Fuji Photo Film USA Inc., in Valhalla, N.Y. "The only way to make really wise decisions about storage is to take the time to define what storage means to your company. Once you understand this, it will be easier to determine your true requirements."

GET THE MESSAGE

Fortunately for business and technology decision makers alike, the maturing storage industry—combined with the introduction of innovative products and services—is helping companies not only to meet the demand for reliable, affordable, fast storage systems, but also to create trusted data solutions.

One critical concern for many companies and government agencies is the preservation of e-mail communications. As e-mail volumes grow—in 2003, exceeding one exabyte (1 million terabytes) for the first time, according to market researcher IDC—the ability to effectively manage so much data shrinks. In addition, with corporate governance regulations taking shape governing e-mail retention and supervision, the ability to quickly and cost-effectively

find specific e-mails in legal discover processes becomes paramount. For example, the state of Florida's "sunshine" law guarantee citizens the right to request copies of all public records, including e-mail, and receive them in a timely manner. The Florida Department of Health recently received an information request that required the organization to retrieve 7,700 related e-mails. Using an e-mail archiving product from KVS North America, a unit of Veritas Software Corp., in Mountain View, Calif., the agency retrieved the e-mails and copied them onto compact disks in only five hours. "This is a process that would have taken more than 1,000 man-hours to complete under our old method of restoring from volumes of backup tapes," says David Taylor, the Health Department's CIO.

"Those are the types of savings that companies commonly see with e-mail archiving software," explains Mary Kay Roberto, senior vice president and general manager of KVS. "As you go through the archiving process, the software helps you to index the information and set policies about what to store where and how long to retain it. These features make searching much easier, more productive and less costly."

MOVIE MAGIC

Some vendors have retooled their entire offerings to meet the changing storage needs of enterprises. Hitachi Data Systems, for example, recently introduced a platform that combines hardware, software, and services to help enterprises get a clear picture of their storage assets and resources across heterogeneous internal and external storage networks. Using virtualization to mask complexity and

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While Fujifilm 3592 is a brand new addition to our full line of superior quality data storage media, it comes from a company that is anything but a new brand. In 1995, our technology enabled the first gigabyte-class metal particle enterprise 1/2" tape. Since then, steady innovation has culminated in a high-end 1/2" tape with NANOCUBIC Technology, the magnetic coating technology leveraged by world-leading hardware manufacturers in development of their latest-generation enterprise-class drive systems. Specify Fujifilm on your next high-end tape order. It's the brand that other brands trust. To find out more about our complete line of reliable data storage media, visit us at: www.fujifilm.com



nanocubic



88%

Companies that plan to maintain or increase their storage spending

CORPORATE TECHNOLOGIES: DATA STORAGE OUTLOOK, 2001

logical partitioning to guarantee quality of service, Hitachi Data Systems's TagmaStore Universal Storage Platform can scale to 32 petabytes and processes 2.1 million I/Os per second.

"By rethinking our solution, we've created a way that companies can define multiple tiers of storage and use the type of storage that makes sense from a cost and availability perspective," says Yoshida of Hitachi Data Systems. "In managing complexity, supporting consolidation, and providing high performance at low cost, this solution addresses the concerns of both executives and IT professionals."

Valuable enterprise data can extend beyond traditional office communications, spreadsheets, and documents. In the entertainment industry, for example, broadcast networks and production companies are facing the time bomb of aging, fading films and tapes. Valuable for their entertainment and historical significance, these resources can be converted to digital images and stored for reuse—at a price. The business decision makers of these companies are beginning to consider the cost of transferring this content to digital media so it can be protected and accessed in the years to

come. "There are thousands and thousands of terabytes of data," explains Solomon of Fuji Photo Film. "But with digital technology, you can transfer 200 full-length movies onto a single high-end tape cartridge—one that's smaller than a paperback book. This not only preserves the movies, but it dramatically reduces the real estate required to store these treasures."

HANDLE WITH CARE

Looking forward, storage industry groups such as the SNIA expect continued development of key technologies

**IS YOUR DATA WHERE IT SHOULD BE?**

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53%

Companies that do not plan to increase their storage headcount

CORPORATE TECHNOLOGIES: DATA STORAGE OUTLOOK, 2004

and standards. The SNIA Data Management Forum has initiatives in place to lead the industry's new approaches to information life cycle management (ILM), addressing the need to align business objectives with where data is stored, for how long the data is retained, and its continuous availability objectives.

"ILM has gained a lot of industry attention," says Childs of the SNIA, "because it addresses the top IT priority needs in the minds of the CIO. Companies need to know who is touching the data, and they need to manage it over time using workflow-based processes that are

connected to the IT infrastructure. Properly planned and implemented, an ILM policy can help companies streamline their storage growth, ensure compliance to industry regulations, and balance the costs against risk."

The SNIA has also devoted considerable effort to storage management issues, recently releasing version 1.1 of its Storage Management Initiative Specification (SMI-S). The organization hopes the spec ultimately will become a standard management interface for all storage devices. As the industry embraces SMI-S, it is facilitating communication

among the wide variety of storage devices present in most storage environments.

TALK AMONGST YOURSELVES

Perhaps the hottest storage technology is IP storage, based on networks using TCP/IP (Transmission Control Protocol/Internet Protocol, the basic communication language of the Internet) to transfer data from the disk storage of one computer to another. Less expensive and simpler to use than the Fibre Channel connections widely used in enterprise data centers, IP storage is



ation Optimized Storage™ Solutions, it moves data between itself and lower tiers and brands of storage they were one. It's the latest example of how Hitachi Data Systems remains committed to being your Beyond Technology. To learn more about our Universal Storage Platform, visit us at www.hds.com

HITACHI
DATA SYSTEMS

UPCOMING EVENTS

CO-PRODUCED BY SNIA AND COMPUTERWORLD
WWW.SNWUSA.COM

Storage Networking World

October 25 – 28, 2004
JW Marriott
Orlando, FL

Storage Networking World

April 12 – 15, 2005
JW Marriott
Phoenix, AZ

Storage Networking World

October 24 – 27, 2005
JW Marriott
Orlando, FL

UPCOMING SNIA EVENTS

www.snia.org

Storage Management Summit

December 6 – 10, 2004
Miami, FL

SNIA Winter Symposium

January 17 – 21, 2005
San Jose, CA

SNIA Technology Summit

August 14 – 19, 2005
San Jose, CA

ILM Solutions

September 18 – 21, 2005
Chicago, IL

UPCOMING COMPUTERWORLD EVENTS

Premier 100 IT Leaders Conference

March 6 – 8, 2005
Scottsdale, AZ
www.premier100.com

Mobile and Wireless World

June 13 – 15, 2005
Scottsdale, AZ
www.mwwusa.com

Enterprise Management World

September 11 – 14, 2005
Philadelphia, PA
www.emwusa.com

IT Executive Summit

September 15 – 21, 2005
www.itexecutivesummit.com

52%

Companies that plan to deploy additional IP storage in the next 12 months

CORPORATE TECHNOLOGIES: DATA STORAGE OUTLOOK, 2004

being widely embraced by companies of all sizes. According to the research conducted by Corporate Technologies, 44% of respondents are already using IP storage, and 52% plan to deploy additional IP storage in the next 12 months.

"In my 24 years in the industry, I have never seen a technology take off as fast as IP storage," says David Dale, chair of the SNIA IP Storage Forum, who also holds the title of industry evangelist for storage company Network Appliance Inc., Sunnyvale, Calif. "The fact that IP storage uses two stable, proven networking standards—TCP/IP and SCSI [small computer systems interface]—gives buyers confidence that they're not on the bleeding edge."

Because most storage administrators have experience with IP networks, "it's not much of a stretch to get them to embrace IP storage," Dale says. In fact, the adoption of IP storage has been inhibited only by the fact that not all storage vendors have had IP storage products available. "By the end of this year, however, that will all change," he predicts. "All vendors will have native IP products." As innovations emerge and existing technologies mature, the most critical success factor in creating trusted data networks may come down to basic business communication. Galvin of Corporate Technologies sees a struggle between what business executives want from their storage systems and what IT decision makers can afford to buy with the budget they have. The solution is to openly discuss the company's business goals and how IT can use storage to meet them.

"Not many companies have an architectural direction established for storage," he says. "This is a mistake.

Thinking strategically about an asset as valuable as storage is the only way to ensure companies get the protection they need at a cost they can afford."

For an executive summary of the "Data Storage Outlook: 2004 Summary Report" by Corporate Technologies Inc., go to <http://www.storageoutlook.com> or call 800.926.9020.

WEB DIRECTORY

Fuji Photo Film USA Inc.
<http://www.fujifilm.com>

Hitachi Data Systems Corp.
<http://www.hds.com>

Storage Networking Industry Association
<http://www.snia.org>

Veritas Software Corp.
<http://www.veritas.com>

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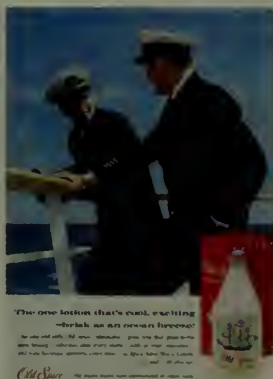
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Extreme Makeover

How Procter & Gamble is selling once-stodgy Old Spice to a whole new generation

WHAT'S THE TOP-selling deodorant and antiperspirant among teen guys? How about Old Spice, a brand once associated with a s-been, highly fragrant aftershave whose ivory bottle still gathers dust on medicine-cabinet shelves. Since Procter & Gamble Co. acquired Old Spice in 1990 it's transformed a small stagnating brand into a men's personal-care powerhouse. And it's not just teenagers. In the past 12 months, Old Spice has inched by Helene Curtis's Right Guard to become the nation's leading deodorant and antiperspirant for men, with 20% of the \$1 billion market, according to ACNielsen Corp. To get there, the Cincinnati consumer-products company had to pull off one of the hardest tricks in marketing: repositioning a familiar brand. "If you told me five years ago that Old Spice would be No.1, I would have said you were dead wrong," says William R. Geary, divisional merchandise manager at Walgreen Co., the largest U.S. drugstore chain. "It's cool where it wouldn't have been cool five years ago." Now P&G hopes to extend its success to an array of Old Spice products.

For a company

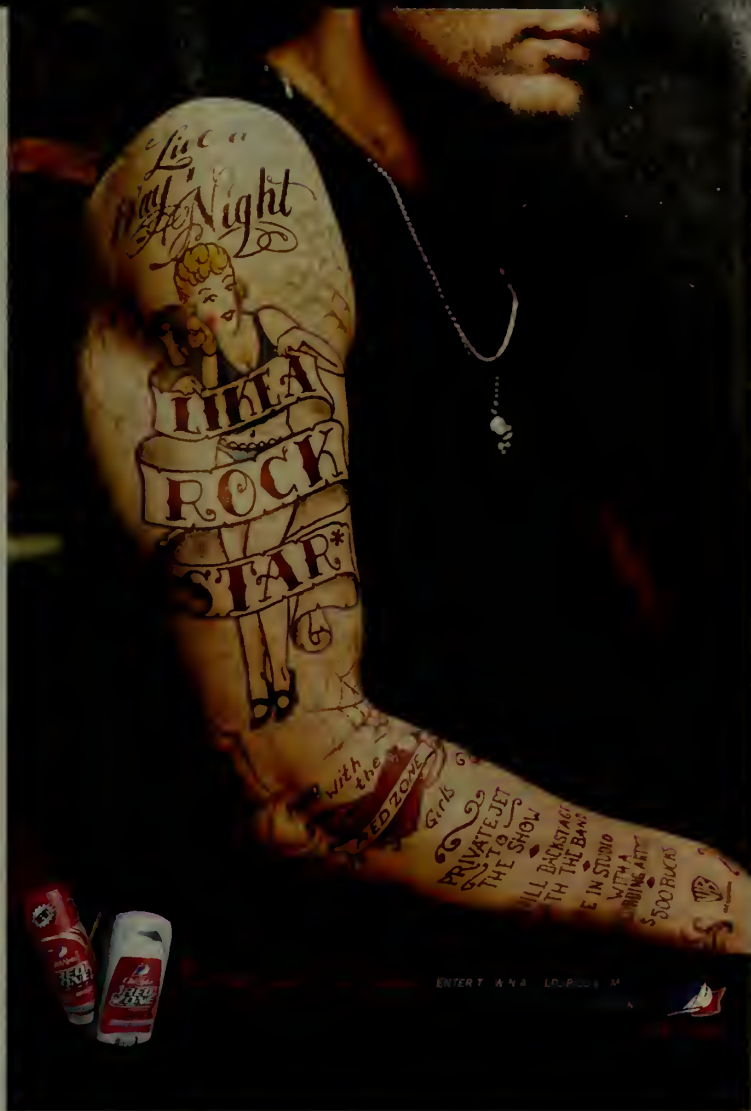


"The one lotion that's cool, waiting...
—for the man who's waiting."
Old Spice

that built its name marketing the likes of Tide, Crest, and Pampers to women, selling Old Spice to men, especially young men, opens up a whole new territory. And it's turning into quite a fight, pitting Old Spice deodorant against Right Guard, with 19% of men's sales, and Unilever's new Axe body spray, with 16%. "We are right on the tail of Old Spice," says Esther Lem, a Unilever vice-president of brand development.

Already No.1 in women's deodorant with Secret, P&G bought Old Spice specifically to get under men's arms. Started in 1937, the brand consisted mainly of an aftershave and cologne business, with a deodorant that ranked a dismal 10th in market share. By 1990 it was known mostly for its graying customer base. That's when P&G bought Old Spice from a unit of American Cyanamid for \$300 million on the belief that it could take the brand younger. Plenty of marketers fail trying to do just that. Look at Levi's and Oldsmobile—or P&G, with

THEN AND NOW
The Old Spice ads have come a long way since 1962

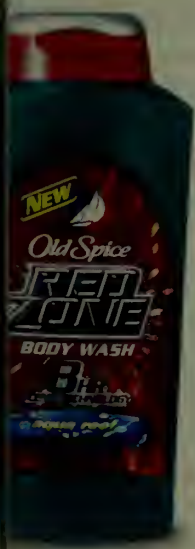


Ivory soap. But P&G bet that because Old Spice was less well-known as a deodorant, the brand could shed the image of your father's aftershave while keeping the masculine and rugged attributes that were a residue from years of ads featuring a whistling sailor with a girl in every port.

SKIPPING A GENERATION

P&G REFOCUSED THE brand on performance, launching Old Spice High Endurance deodorant in 1994. It ditched the sailor ads and targeted guys 18 to 34, challenging them to use the product or get their money back if not satisfied. That appealed to David Celis, 17, a high-school senior in Chicago, who has been using Old Spice deodorant for three years. "It sounded appealing," he says. "If they say they would buy you another one, they must be confident people will like it."

The deodorant business grew steadily, but P&G realized it wasn't drawing in men 25 to 45, who still remembered Old Spice as a relic from Dad's era. So P&G decided to skip a generation and aim the brand at first-time deodorant users. To reach this younger group, in 1999 P&G



started handing out samples of High Endurance to fifth-grade health classes, covering 90% of the nation's schools, as well as handing out "scratch-and-sniff" book covers to junior highs. Those kid customers offered another advantage—they would pay a higher price because they had no experience in buying deodorants. In 2000, P&G launched Old Spice Red Zone, a sub-brand that cost 25% more than High Endurance and offered more protection. Sales took off, with Old Spice edging out Right Guard as the top teen brand in 2001, P&G says.

GRASSROOTS MARKETING

TO GET THERE, P&G has had to go well beyond the 30-second TV commercial since teen boys spend less time watching TV. It still does TV campaigns, including some involving NASCAR driver Tony Stewart and National Football League player Brian Urlacher. But P&G has done much more grassroots marketing. It hands out samples at skateboarding events and sponsors a contest for high-school football player of the year that gets the product into locker rooms. It has also placed Old Spice within video games, including Electronic Arts Inc.'s *NCAA Football 2005* game.

Competitors are hardly sitting still. Gillette carved out an edgier position when it launched Right Guard Xtreme in 2001. To kick off the recent introduction of Extreme Cool Spray—a newfangled aerosol that sprays vertically out the top—it ran ads in movie theaters and on TV featuring one of the stars of MTV reality show *Pimp My Ride*. Unilever turned the U.S. male deodorant business on its head in 2002 with the launch of Axe body spray, which it has backed with risqué television, Internet, and event advertising. The combination deodorant and fragrance proved hugely popular with young men.

P&G sees Old Spice as a beachhead into other products. It has already launched Old Spice body sprays and body washes and has licensed sales of razors and shaving cream. It even thinks it can revive aftershave and cologne sales. "This brand has the legs to be a male-grooming megabrand," says P&G marketing director Alex Lipinski. That old sailor must be whistling a new tune. ■

—By Robert Berner in Cincinnati

BusinessWeek online For an interview with Esi Eggleston Bracey, P&G's general manager of antiperspirants and deodorants, go to businessweek.com/magazine/extra.htm

Can Charlie Ergen Still Go It Alone?

His EchoStar is facing bigger cable rivals —and Murdoch's deep-pocketed DirecTV

EVEN IN THE MOGUL-EAT-mogul world of media, it's hard to top Charles W. "Charlie" Ergen for pure tenacity. Starting in 1980 by selling an oversize backyard dish door to door across Colorado, the 51-year-old former professional blackjack player built EchoStar Communications Corp. into a \$6 billion-a-year satellite-TV powerhouse. His m.o.: slashing prices to undercut rival cable rates and giving away free dishes.

But today the cable guys are far more formidable, having consolidated from 62 to 25 companies over the past decade, and Ergen's biggest satellite foe, DirecTV, is now in the hands of Rupert Murdoch's deep-pocketed News Corp.

That leaves EchoStar facing the fiercest competition in its 25-year history. Earnings are down, in part the result of CEO Ergen having to spend heavily to match splashy new ads and giveaways by DirecTV. Now several Wall Street analysts are wondering if Ergen has the muscle to go on, or whether he might consider partnering—or even selling his company. "I would never want to underestimate Charlie Ergen, but the game has changed for him," says analyst Aryeh Bourkoff, who follows cable and satellite for UBS Securities. "I'm

not sure he can continue to go it alone without finding a partner."

EchoStar's Dish Network is still adding subscribers at a brisk pace, stealing disgruntled cable customers with offers of cheaper programming, crisp digital pictures, and better service. But EchoStar, which has 10.1 million subscribers, vs. 13 million at DirecTV, spends an average of \$590 to add each new subscriber in the first half of the year. The strategy depleted Dish profits in a big way (table), from \$178 million in the first half of 2003 to \$45 million for the same period this year. By contrast, DirecTV added an impressive 915,000 subscribers, spending an even pricier \$645 for promotions that included splashy ads, discounted digital video recorders, and four months of free service.

Apparently Murdoch is just getting warmed up. In August, he spent \$900 million to buy Paycom's 1.1 million subscribers, giving it a giant foothold in the rural communities where EchoStar has outsold DirecTV in the past. In September, DirecTV said it would spend an estimated \$1 billion to launch four satellites by 2007 that will give it the ability to provide high-definition signals for more than 1,500 locations covering most of the country. By then, DirecTV also intends to offer

Big Price for Growth

EchoStar's Dish Network is gaining subscribers...

2003
8.8
MILLION

2004*
10.1
MILLION

...But costs per sub rose 28%...

2003
\$460

2004*
\$590

...Pushing profits down 75%

2003
\$177.8
MILLION

2004*
\$45.3
MILLION

*First half Data: EchoStar Communications



ERGEN "Sometimes
you have to tread
water"

kind of interactive services, including shopping by TV and video-on-demand, that helped Murdoch's 48%-owned British Sky Broadcasting Group PLC become a runaway success.

NETWORK UPGRADES

MURDOCH'S NEWS CORP., which withstood more than \$2 billion in losses in the 1990s before BSkyB became the industry leader in Europe, is hardly Ergen's only problem. Cable operators, long vulnerable to satellite operators because of their overpriced packages and uneven service, are completing an \$85 billion upgrade of their networks. That will allow them to retain more customers by offering phone, video-on-demand, and other services. And on Oct. 14 new rules by the Federal Communications Commission opened the door for phone companies to offer video to their customers. That prompted C Communications Inc., an EchoStar marketing partner that has helped add

more than 100,000 Dish subscribers this year, to say it would accelerate a \$6 billion upgrade of its system to fiber-optic lines so that it, too, can sell TV services.

So what is the No. 2 satellite exec to do? Ergen just keeps on pushing. Along with SBC, he's planning a video-on-demand service and to offer more local signals, key to luring new subscribers. So far, Dish offers local news and programming in 151 markets, vs. around 116 for DirecTV. He has also overhauled his business plan, dropping Dish's requirement that new customers pay in advance for a year's programming if they choose to just lease their dish and set-top boxes and not purchase them. Now EchoStar can change how it accounts for the boxes, figures Morgan Stanley analyst Benjamin Swinburne, who projects that the new lease plan

will defer expenses and boost cash flow by 57% this year and 38% in 2005. The downside: With fewer long-range commitments, EchoStar will see more subscribers jump ship.

All these threats have dimmed EchoStar's luster on Wall Street. Despite a stock buyback program and the refinancing of more than \$2.4 billion of its high-priced debt, EchoStar's stock, at about \$33, is off by 4% this year, even as DirecTV's share price has climbed by 8%, to about \$18. "Everything that Charlie has done so far is financial engineering," says Jea Shim, an analyst with Tradition Asiel Securities Inc. Shim worries that EchoStar, which has recently signed deals with other phone companies to sell its subscriptions, is leaving too much of its future in the hands of other companies. "It does raise the question of long-term strategy for EchoStar," Shim writes in a recent report.

Having scale would clearly help Ergen in a world of media giants, particularly when it comes to negotiating with programmers such as the Walt Disney Co.'s ESPN, whose fees account for more than 40% of EchoStar's overall operating costs. But Ergen, who declined comment for this article, isn't offering any hints about his intentions. Holding a 50.3% stake in EchoStar, Ergen could take the company private. Or he could seek a merger partner. SBC, which has invested \$500 million in the company's bonds, has an option to convert those into a small equity stake. He could also merge with a major media player, giving him a ready supply of content for new services. Viacom, NBC, Disney, and even satellite radio newcomers Sirius and XM Satellite Radio have been mentioned, although none has openly expressed interest. "Sometimes you have to tread water," Ergen told investors in August. "It's hard to know where you place your bet today as an investor because you have broadband, satellite companies, and cable companies kind of all vying for the same thing."

Or Ergen might simply choose to go it alone. But for how long? "There are still a lot of cable subscribers out there for him to steal away," says William E. Jacobs, an

analyst with Harris Associates LP, which owns 2.9 million EchoStar shares. "But down the road in two years or so, he'll have some important decisions to make." For one of the most tenacious men in media, hanging tough has gotten a whole lot tougher. ■

—By Ronald Grover in
Los Angeles

**EchoStar's
stock is off
by 4% this
year, while
DirecTV's
has risen 8%**

Making The Most Of Your Losses

How your portfolio's ailing stocks can help trim your tax bill. **BY LAUREN YOUNG AND SUZANNE WOOLLEY**

IT LOOKS LIKE 2004 WILL GO down as a schizophrenic year for investors. Energy and telecom stocks are recording double-digit gains, but many technology and drug stocks are ailing. Just look at blue-chip losers such as Merck, down 33%, and Intel, down 35%. Maybe next year those losers will soar again, but for now you can use the rotten apples in your portfolio to trim your tax bill. The strategy is simple. Sell your losers to generate tax losses that can offset any gains you've taken or

plan to take. If you have more losses than gains, you can apply up to \$3,000 against other income—anything more, you can carry over for another year. You may be reluctant to sell for a loss because you think the stock or mutual fund in question has strong prospects. But there are ways to, in effect, harvest your tax losses and keep the stock too. The one caveat: To claim a loss for tax purposes, you can't buy back a security for at least 31 days (table).

For example, if you still really like Merck—now reeling from the recall of blockbuster painkiller, Vioxx—but you are harboring losses, you could sell it and replace it with shares of another big drug maker. But that could be risky if the new company gets into trouble, too. One option is to buy an exchange-traded fund (ETF) that specializes in pharmaceuticals, says Tobias Levkovich, chief U.S. equity strategist at Citigroup Smith Barney. A few good ETF candidates are iShares Dreyfus US Health Care and Vanguard Health Care VIPERS—both have large pharmaceutical holdings and hold Merck among their top five stocks.

Perhaps the best place to look for losses is in the tech sector. Particularly hard hit are semiconductor stocks such as PMC-Sierra (down 56%) and LSI Logic (down 52%). One option is to sell them and replace them with an ETF such as iShares Goldman Sachs Semiconductor. Or you could replace them with semiconductor stocks as KLA-Tencor and Helix Technology, which build the equipment for manufacturing semiconductors, suggests Vadim Zlotnikov, chief investment strategist at Sanford C. Bernstein. They'll be big beneficiaries of a rebound in capital spending.

MICROSOFT PLAY

BOTH LEVKOVICH and Zlotnikov are cool toward tech stocks now, but if economic growth picks up next year, tech will be the place to be. So if you still like

Strategies for Tax-Smart Selling

As the end of the year approaches, here are several ways to make the most of your investment losses:

THE HARVEST

HOW IT WORKS Sell losing stocks to realize tax losses. Optimize short-term losses should be matched against short-term gains; long-term losses against long-term gains.

WHAT'S BEHIND IT The law allows you to apply capital losses against gains and wipe out your tax liability. If losses exceed gains, you can only apply up to \$3,000 against other income. You can carry excess losses into future years.

RISK What you sold goes up, and you miss the gains.



h's prospects but don't have a strong preference for a particular stock or sector, replace your loser with an ETF such as the NASDAQ-100 Index Tracking Stock, also known as Qubes, or the Technology Select Sector SPDR, which owns the tech stocks in the Standard & Poor's 500-stock index.

What about Microsoft? It enjoyed a short-term gain last summer when it announced it was making a \$3-a-share special dividend. Shareholders of record on Nov. 17. But the stock has been flagging since and is down for the year—and will likely sell off on Nov. 18, when the stock starts trading without the dividend.

If you want to sell Microsoft and you've held the stock more than a year, it doesn't really matter if you sell before or

after the special dividend's record date. Any gain would be taxed at 15% anyway, and any loss would be long-term. If you have a short-term gain of \$3 or more, though, and will have owned it for 61 days, wait until after the dividend is paid. That way the \$3 per-share payout is taxed at 15% rather than at a short-term capital-gains rate as high as 35%.

What if you have a loss on Microsoft? Just get out, says Robert Gordon, president of Twenty-First Securities. Here's why: Say you paid \$29 for the stock within the past year and it's at \$27. If you sell now, you have a \$2-a-share short-term loss. If you wait until after the dividend is paid, the stock is likely to fall at least by the amount of the special divi-

dend. That means your \$27 stock drops to \$24. You have to pay tax on that \$3, and you have a \$5 capital loss to boot.

Of course, now's the time to think about taking gains in addition to losses. You'll find profitable selling opportunities among the energy stocks. If you think oil prices have all but peaked, cash in and go elsewhere. If you think energy is in a long-term bull market, you can still sell to realize gains and immediately repurchase the stocks.

You may consider taking gains among the smaller, riskier drillers or refiners and moving the money into the giants such as ExxonMobil and ChevronTexaco. They're more defensive and more diversified, says Oppenheimer & Co. senior energy analyst Fadel Gheit. They also have ample

DOUBLE-UP

HOW IT WORKS If you own say, 100 shares of a losing stock, buy 100. Sell the original 100 after 31 days to realize loss.

BEHIND IT The move maintains your position in the stock while avoiding a tax loss.

After 31 days, at least, you've increased your risk of further loss. One solution: You can buy a put option on 100 shares and sell it at the same strike price, which helps offset the cost of the stock. It will hedge the extra shares during the 31 days.

THE SWAP

HOW IT WORKS Sell a losing stock and replace it with a similar stock, exchange-traded fund, or mutual fund that invests in the same sector. You need to hold the replacement at least 31 days if you want to buy back the original.

WHAT'S BEHIND IT It maintains asset allocation and investment in an industry while you're taking a tax loss.

RISK Substitute investments may go down, too. Do it only if you're bullish on the stock or industry.

dividends—2.2% and 3%, respectively.

Taking tax losses is not just about stocks. You can do it with your mutual funds, too. Large-company growth funds are down for the year, and that's one place to consider some selling.

Still, you don't want to be out of them entirely, since many analysts expect the bigger companies to outperform their small-cap peers in 2005 after a prolonged period of gains for small caps. So you may consider a swap, selling a large-cap fund and buying a similar one. If you're sitting on losses in the Vanguard 500 Index Fund, a large-company blend fund, you may want to substitute it with the Vanguard Total Stock Market Index Fund. About 70% of the stocks in the two funds overlap. That's a favorite move of Gary Schatsky, a financial adviser at the ObjectiveAdvice Group in New York.

One warning: Before you trade in and out, make sure the new fund isn't about to make a capital-gains distribution, Schatsky says. Otherwise you might be welcomed into a new fund with a tax bill for capital gains that were earned long before you arrived. Check with the fund company directly if you plan to make any purchases before Dec. 31. Most companies will tell you when they plan to make a distribution—and sometimes even how much.

TRADING COSTS

IN ALL LIKELIHOOD, distributions will not be big this year. Plenty of funds are still carrying losses from the bear market, and they, like individuals, apply gains against losses to avoid making taxable distributions. Sometimes, it's even a good idea to buy funds with large tax losses; they'll shelter gains for a while. To find those funds, go to *BusinessWeek's* Mutual Fund Scoreboard (bwnt.businessweek.com/mutual_fund). Look in the last column, "Untaxed Gains," of the equity fund scoreboard. A negative figure indicates the fund has losses that may offset future gains, and the larger the number, the greater the losses on the books.

Keep in mind the cost of making your yearend tax trades. Factor in the brokerage commissions, for example, when you buy and sell an exchange-traded fund or option. Plenty of mutual funds now have 2% redemption fees if you sell within a set period, often 90 days or less. And it's best to avoid jumping into any funds with sales loads if you are only parking your cash there for a short time. The point is to avoid paying taxes—not to rack up a lot of extra charges. ■

Time to Do Your Tax Checkup

Rule changes offer new breaks. **BY ELLEN HOFFMAN**

ONLY TWO MONTHS remain in 2004, which means it's time to start your end-of-year tax planning. There are a few new wrinkles to consider, including one benefit that comes to individuals courtesy of the tax bill that's awaiting the President's signature. Starting this year, taxpayers will have the option of taking a deduction for state sales taxes instead of state income tax. The change is a boon for residents of nine states with no income tax, including Florida and Texas. Congress eliminated the sales tax deduction in the 1980s.

Taxpayers who pay state income tax typically generate a larger deduction. But that may not be the case if you've bought—or buy before yearend—an expensive item, such as a car or boat. You just might cough up enough sales tax to make the deduction worthwhile.

Whichever one you choose, you could end up losing it if you trigger the alternative minimum tax. That's intended to make sure the very wealthy pay at least some tax, but it ends up catching millions of taxpayers with more moderate incomes. Under the AMT, you first calculate your tax the regular way, and then again, using the form 6251, which does not allow you to take many of the juiciest deductions. You pay the higher amount.

A preliminary run-through may help you determine whether you're heading into the AMT zone. If you're unlikely to be hit in 2004 but may get trapped in 2005, one strategy would be to accelerate deductions—such as pay your January real estate taxes in December—to make the most of the deduction now.

When doing your tax checkup, you should also consider these items:

► **401(k) contributions** Make sure you're on track to put the maximum



contribution into the account for 2004. The 2004 limit for a 401(k) is \$13,000 plus an additional \$3,000 if you're 50 or older.

► **Charitable donations** Are you thinking about donating your clunker to a worthy cause? You'd better do it now, because the rules for valuing a car will be tougher in 2005.

► **Clean-fuel vehicle deduction** Get a \$1,500 write-off for buying a hybrid car. Check the qualifying vehicles in Tax Table 2004-59 at irs.gov.

► **IRA contributions** The deadline to put in up to \$3,000 (\$3,500 for a married over-50 taxpayer) is when you file your taxes, or Apr. 15. If you or your spouse has a retirement plan at work, the amount you can deduct phases out. Remember that contributions to a Roth IRA are not deductible.

► **Medical expenses** You can deduct these only if the amount exceeds 7.5% of your adjusted gross income. If you're close to or over the limit, get that dental crown, stock up on your prescriptions, or have your annual checkup—and pay for it all no later than Dec. 31. ■

Isn't it time you had a Quiet Conversation™ of your own?

ESTATE PLANNING

It's time for a Quiet Conversation.

Spending Your Golden Years In the Big Apple

Many seniors are shunning the Sun Belt for New York's variety. **BY LAUREN YOUNG**

IRWIN AND AUDREY GREENblatt lived the typical suburban life for more than 27 years, raising two kids in a split-level house on a half-acre outside of Philadelphia. As they neared retirement from a private high school they owned for at-risk teenagers, the Greenblatts planned to spend their golden years at their beach house on the Jersey Shore. But when their older son

going to the theater, visiting street fairs, taking long walks in Central Park, and substitute teaching at a nearby private school. Although they didn't know anyone in the city aside from their son, they've quickly bonded with neighbors—one was Winston Churchill's secretary—and with other teachers. "Retirement in Florida would be boring for us," Audrey says. "At 8 p.m. you are planning breakfast the next day."

provides a lot to the searching senior says Michael I. Markowitz, director of the Institute for Retired Professionals at New School University. Served by three major airports, New York also is a great launching pad for travel.

NOISY AND CROWDED

INDEED, NEW YORK is a haven for retirees. While the city doesn't have statistics on non-native transplants, about 1



GREEN HAVEN The Greenblatts take a daily walk in Central Park



STROLLING "Retirement in Florida would be boring," says

moved to New York, they became enchanted with the vitality and excitement of the big city. "The more time we spent at the shore, the more we realized it was a cultural wasteland," says Audrey, 59. "New York made us feel young." The Greenblatts sold their shore house, and to see if they could live in the city as retirees, they decided to take a test run five years ago and rent a Manhattan apartment. They liked it so much they also sold their Philadelphia home and bought an 850-square-foot, one-bedroom co-op near Lincoln Center 12 months later.

Now the Greenblatts spend their time

Plenty of retirees like the Greenblatts are shunning warm-weather destinations once favored by the geriatric jet-set for the bustling pace of the Big Apple. New York is home to some of the best theater, museums, dance troupes, and musical groups in the world. With dozens of teaching hospitals, it boasts top-notch health care, as well as an extensive public transportation network (with reduced fares for seniors) and more than 2,000 restaurants. Virtually anything you need can be found—and delivered—around the clock. "New York has the infrastructure and cultural as well as social milieu that

million people aged 60 and over are living in its five boroughs, according to New York City's Aging Dept. That's roughly one-eighth of the population.

Life in the nation's largest city does have its drawbacks. New York is noisy and crowded. You'll probably experience sticker shock the first time you visit a supermarket or drugstore, in part because the sales tax is 8%+. And the city can be a lonely place. In shows such as *Seinfeld* and *Friends*, people are always dropping by, but that's not realistic. "Here everything is by appointment," says Karen Altfest, a financial adviser at LJ Altfest & Co. in New York

Your main housing option in the Apple is an apartment, and vertical living takes the place of the horizontal space used to, especially for people accustomed to lots of storage space as well as a garage and garden at their doorstep. Buildings, meanwhile, aren't always pet-friendly, and most newcomers eventually give up their car after paying \$400 or more per month for parking.

Unlike states such as Florida with no income tax, New York's taxes are steep. The state's top tax marginal rate is 7.7%, and you'll pay an additional 4.5% if you live in New York City. If you own your own residence, the mortgage-interest deduction will mitigate some of that bite. Then again, housing is expensive. The typical one-bedroom co-op apartment costs \$469,000, while the average one-bedroom condominium sells for \$466,000, according to recent sales data from Corcoran Group, a real estate firm. You may find better deals renting. But the typical one-bedroom apartment rental is still about \$2,310 a month, and many of the giveaways that freshly constructed

midtown by subway. Queens and Staten Island are even cheaper. "I think of New York as the five boroughs and not just Manhattan," says Janet Hays, author of *Retire in New York City—Even if You Are Not Rich* (Bonus Books, \$14.95).

Whether you decide to rent or buy, test the waters first as the Greenblatts did. Hays suggests looking for a two- or three-month sublet in *The New York Times* classifieds—it helps to make friends with someone who subscribes because regular readers get a leg up on Saturdays, when the Sunday real estate section is delivered. Craigslist (newyork.craigslist.org/sub) is another extensive resource for sublet listings.

Once you begin your temporary stay, Hays says you should avoid tackling the large issues such as selling your home and finding a doctor immediately. Instead, she suggests focusing on daily

You can still find good housing deals at the edges of the city

years, Bob Ashton, a former Procter & Gamble manager, passed up the waving palm trees of the Fiji Islands to retire to New York two years ago. "I can't stand golf, and I can only weed so many gardens," says Ashton, now 75. "I can only ski so many days, climb so many mountains." The best way to make friends, he says, is to get active in something that inter-

ests you. "People can get lost here," he says. "The skill of meeting people is vital." Ashton, naturally, is a member of the Explorers Club and belongs to museums and singing groups.

A GOOD MATCH

ANOTHER WAY to make friends is to volunteer. If you like the ballet, contact one of the major ballet companies. Keep in mind that everyone wants to be a docent at the Metropolitan Museum of Art, but plenty of smaller museums can use help.



COLN CENTER The Greenblatts bought a condo nearby



AT THEIR SON'S PLACE They knew no one else in New York

high-rise buildings were offering last year (a couple of months of free rent, and even the high-definition TVs) have dried up as the economy has rebounded.

ALL FIVE BOROUGHS

WELL, YOU CAN FIND good housing deals if you are willing to live in neighborhoods at the city's perimeters, including the Wall Street area and Riverdale in the Bronx. Although Brooklyn Heights is pricey, retirees are finding decent options in other parts of Brooklyn, including nearby Carroll Gardens, which is about 30 minutes from

life—going to the supermarket, getting a prescription filled, riding the subway—and see if it appeals to you.

If you decide you are ready to take the plunge, talk to a financial adviser, preferably one who is based in the city with a clientele of local retirees. The right adviser can evaluate your finances and figure out how much you can afford to spend on an apartment, as well as whether you should rent or buy. You'll also want to discuss a budget to get a good sense of what you've got to spend each month for food, activities, and travel.

After sailing around the world for 10

A good starting place is the Retired & Senior Volunteer Program (rsvp.cssny.org), which has more than 9,000 volunteers serving 600 organizations. It can help match you with a group that best suits your interests and skill set.

If volunteering isn't your cup of tea, try taking a class. Nearly all the city's universities have programs targeted at retirees. New School enrollees, for example, study everything from genetics to James Joyce's *Ulysses* (nsu.newschool.edu/irp/). It's a great way to take a bite out of the Big Apple—and learn something in the process. ■

Personal Business Autos



FORD'S ESCAPE
It does dirt trails,
is roomy—
and gets 33.3
miles per gallon

Hybrids with Plenty of Pep

The new Ford SUV and Honda sedan deliver both comfort and performance. **BY KATHLEEN KERWIN**

THE FIRST GAS-ELECTRIC hybrid cars were odd-looking vehicles that advanced the frontiers of auto technology but offered little in the way of horsepower, passenger space, or cargo room. On the other hand, the two newest entries, versions of the popular Ford Escape sport-utility vehicle (BW—Oct. 18) and Honda Accord sedan, have room, pep, versatility—and impressive mileage. Like all hybrids, their batteries recharge by recapturing energy from braking and cruising on highways. You never have to plug them in.

Ford Motor's first hybrid, the compact Escape SUV, aims to show you can have it all. This cute-ute now arriving in showrooms proves remarkably capable on steep, rocky dirt trails, although the optional all-wheel-drive is more likely to come in handy on snowy or slippery roads. It can easily carry five passengers, with plenty of room for gear. And it gets 33.3 miles per gallon—50% better than

the regular Escape and 25% more than the most fuel-efficient gas-driven SUV, the smaller Toyota RAV-4 at 26.7 mpg.

Like most hybrids, the Escape starts up silently. You have to watch the instrument panel to tell if the motor is running. The SUV can run up to 25 miles an hour on electric before the gas engine kicks in. Like other hybrids, the Escape's gas engine shuts off at stoplights, creating an eerie hush. During acceleration, the electric motor acts like a turbocharger, helping the 4-cylinder engine crank out al-

THE HONDA ACCORD
It's the first to mate
an electric motor to
a V6 gas engine



most as much power as a V6. The hybrid Escape gets better mileage in driving (36 mpg) than the highway (31 mpg).

The new Accord, which goes on sale Dec. 3, is the first hybrid to mate an electric motor to a V6 engine. Honda keeps the Accord fuel efficient at 37 mpg by using "displacement on demand," which shuts down three of six cylinders when power isn't needed. When you floor the accelerator, the electric motor joins the six cylinders to pump out 255 horsepower—15% more than the regular Accord. Oh yeah, you

can go 633 miles on a tank of gas.

Unlike full hybrids, the Accord can propel itself by electric power alone, though it reverts to electric-only when idling. So after starting silently, the engine comes on when you hit the accelerator. This type of hybrid gets better mileage on the highway (37 mpg for the Accord) than in city driving (30 mpg).

Deciding among these hybrids depends on whether you want off-road ability, more horsepower, and whether you do a lot of stop-and-go commuting or spend more time at highway speeds. Both companies guarantee their batteries for 8 years or 100,000 miles at Ford, 80,000 miles at Honda—important because replacing them could cost several thousand dollars.

The hybrid Escape starts at \$26,900, and the hybrid Accord is expected to start at \$30,000. That puts the price of the hybrids about \$3,400 above their gas-only counterparts. Either vehicle might save you about \$350 a year at current prices—not enough to offset its price premium for years. But if you want the latest technology, with performance and practicality, all in an earth-friendly package, the new breed of hybrids may be for you.

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RETIREMENT

Underfed Pensions



JUST WHEN CORPORATE America's pension funds were starting to perk up, a sluggish stock market is knocking them down again. The pension plans of companies in the **Standard & Poor's 500-stock index** will likely end 2004 with a 19% shortfall between their assets and obligations to retirees. That's even bigger than last year's 13% gap, says **Credit Suisse First Boston** accounting analyst David Zion. Why? While investment returns have been flat, companies have withdrawn money to pay benefits. Meanwhile, obligations to future retirees continue to climb. The deterioration comes on the heels of a sharp improvement in 2003, thanks to a strong stock market.

Some companies may be forced to shore up their beleaguered plans with cash contributions in 2005. Among those Zion expects to divert a large percentage of operating cash flow to their plans: **Goodyear Tire & Rubber** and **Navistar International**. Navistar says the \$220 million it put into its pension plan this year should suffice. Goodyear expects to

contribute up to \$350 million in 2005. The good news: If the interest rates used to discount—or calculate—the value of pension obligations continue to climb, the size of those obligations will fall. So pension funds could swing into the black. **Bear Stearns** analysts project an aggregate surplus for the S&P 500 of 2% by 2006. —Anne Tergesen

COMMODITIES

THE RECENT HURRICANES devastated Florida's orange crop: The harvest is down nearly 30% this season. As a result, frozen orange juice concentrate futures contracts on the New York Board of Trade have jumped 35% since August, to 84¢ per pound. But juice lovers may not be paying more for their morning sunshine. Last year's record crop resulted in a 30% increase in inventories, which is likely to keep prices stable.



WINE

A FOOL-PROOF WINE STOPPER WITH PIZZAZZ



SAFE OR STYLISH?

That's the conundrum top vineyards face when deciding between a traditional cork, which can taint wine, or a

screwcap, which many consumers see as too tacky for a good bottle. Aluminum giant **Alcoa** offers a solution that could let vintners offer both: **Vino-Lok** is a glass stopper with a rubberized ring that, like a screwcap, prevents contamination or oxidation. But like a cork, it's elegant. Wineries can color or engrave the stopper with their logo. To open the bottle, you twist and pull out the stopper, much like a Champagne cork. You can also reinsert the stopper. Alcoa says **Vino-Lok** will appear on wine bottles early next year. —Jane Black

Q & A

ARE YOU PAYING TOO MUCH FOR THAT BOND?



Q: I have been buying mortgage bonds from my broker. Most of these I buy in \$100,000 denominations. What

does my broker make in commissions on each of these? I'm guessing 1% to 2%.

—Eric Gerencser, Myrtle Beach, S.C.

A: Pretty good guess. A broker typically would mark up the securities 1% to 3%. If you want to know what the firm's take is, ask. If your broker won't tell you, try a discount brokerage. Instead of taking a percentage cut of a bond's face value, some charge a flat fee. Vanguard, for example, gets \$50 per bond trade of any size. For \$100,000 in mortgage bonds, Fidelity Investments would charge \$500 for a round-trip (buy and sell) trade.



BY ROBERT BARKER

A Hollywood Play For Dreamers Only

In *Shark Tale*, DreamWorks Animation's latest hit, a little hustler of a fish named Oscar (voiced by Will Smith) just can't stand the truth. In the ocean's hierarchy, he's below plankton, lower even than whale poop. "Nobody loves a nobody," Oscar tells his angelfish pal Angie (Renee Zellweger). "I want to be a somebody."

Who doesn't? And surrendering to that urge is all that can explain why anyone puts money into Hollywood stocks. The latest case of this investopathy is DreamWorks Animation, maker of such computer-generated animation (CGA) blockbusters as *Shrek* and *Shrek 2*. It aims soon to split from parent DreamWorks SKG, the studio run by three amigo moguls (Steven Spielberg, Jeffrey Katzenberg, and David Geffen), in a \$700 million initial public offering. DreamWorks plans to use \$355 million to pay off debt and keep \$175.5 million for working capital. The rest, after fees, is going to such selling investors as Microsoft and its co-founder, Paul Allen.

ALLEN, AS IT HAPPENS, has been DreamWorks' chief angel since its formation back in 1994. The animation arm produced its first feature in 1998 and now has nine to its credit. With *Shrek*

DreamWorks Animation in 2004 posted first-half net income of nearly \$121 million on a 8% jump in revenue, to \$341 million. Had it been its own public company, however, revenue could have come to just \$182 million and net \$67 million (table). Why? Taxes, for one thing. And as an independent company DreamWorks Animation would recognize revenue only after an 8% fee right off the top to its parent in an exclusive distribution deal, plus actual marketing expenses. On this basis, DreamWorks Animation in 2003 would have lost \$158 million on \$173 million in revenue.

Last year was especially bad, with just one feature and write-offs of two scuttled projects. DreamWorks aims to release two titles a year. Both are hits, as *Shrek 2*—with \$437 million in U.S. box office, the third-highest grossing in ever—and *Shark Tale* have proved, then profits will be a snap. Yet there's little room for dud. DreamWorks' registration statement notes that the average studio releases 29 titles



a year, spreading risks. It also points out that as CGA expands—Sony Pictures Entertainment and Lucasfilm are jumping in—competition will heat up. The CGA features that first delighted moviegoers in 1995, when Pixar Animation Studio released *Toy Story*, may begin to seem commonplace.

As DreamWorks' No. 1 rival, Pixar boasts a much higher market value: \$4.7 billion, vs. \$2.5 billion for DreamWorks if it goes public at its estimate of \$24 a share. But there are some notable distinctions. First, from 1999 through June 30 this year, Pixar steadily posted net profits that total \$442 million. DreamWorks in that span lost a total of \$246 million.

Next, Pixar owes no debt and holds \$755 million in cash and high-quality bonds that mature in two years or less; on June 30, DreamWorks held \$10 million in cash against debt and a variety of other obligations totaling \$666 million.

Based in the Bay Area, Pixar also is more tech shop than Hollywood studio. Buy a share in Pixar, and you get one vote, same as CEO Steve Jobs, who owns 53%. Buy stock in DreamWorks Animation, however, and you will own Class A shares, good for one vote per share. Katzenberg and Geffen, who together own 13% of the company, will control 46% of the equity in the form of Class B shares. These carry 15 votes each and give them 93% of the votes. Then there's the single share of Class C stock. It will go to Allen, and lets him pick a director to sit with him on the board. In Hollywood's hierarchy, public investors are lower than, well, you know. ■

E-mail: rb@businessweek.com

DreamWorks: How Animated?

Revenue	\$182
Operating income	110
Net income	67
Debt and other obligations	666
Indicated equity value	2,535
Next release	<i>Madagascar</i> , spring 2005
Symbol	DWA

Data are for six months ended June 30 in millions, and assume operation as an independent company

Data: Company reports



BY GENE G. MARCIAL

HOMELAND SECURITY IS SENDING **MINE SAFETY** EVER UPWARD

OIL'S SURGE IS FLOATING **TRANSOCEAN'S** DEEPWATER RIGS

HUNGRY VALUE INVESTORS GATHER AROUND **SYSCO'S** LEAN STOCK

That's One Safe Stock

CHEMICAL BIOLOGICAL MASKS, advanced combat helmets, and self-contained breathing apparatuses are some of the products driving strong sales at Mine Safety Appliances (MSA), global leader in body protection gear in markets in 120 countries. The 90-year-old company "is benefiting from the focus on homeland security and domestic preparedness," says Elliott Schlang of institutional research outfit LJR Great Lakes Review. Mine Safety's homeland business is growing at a "phenomenal rate," says Schlang, who owns shares. Besides the billions the federal government is spending on the war on terrorism, he notes, only 14% of the \$2.3 billion budgeted for states by the Homeland Security Dept. has been awarded so far. Firemen, police, and industry use Mine Safety's other wares, such as gas detection gear and air-purifying respirators. Its stock seems bulletproof, too, rising to 37 from 18 a year ago, reflecting compounded yearly earnings growth of 57% over the past five years. While that can't last, Schlang expects at least 15% growth and sees shares at 46 in a year. He pegs earnings at \$1.90 a share in 2004 on sales of \$830 million, vs. 2003's \$1.31 on \$696 million. In 2005, he sees \$2.19 on \$942 million. Richard Eastman of securities firm Robert Baird (it did banking for Mine Safety in the past year) rates the stock outperform, saying earnings will support share buybacks and dividends it has paid for 86 consecutive years.

THE SCARIER THINGS GET...

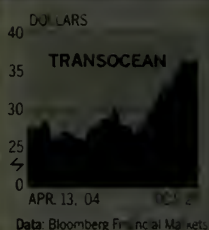


A Sea Change In Transocean's Favor

AFTER TREADING WATER much of the year, Transocean (RIG) is finally catching up with its peers. Since mid-August, the stock has risen from 23 to 36. Still, shares of the world's largest offshore driller—mainly deepwater and harsh-environment drilling—are up a mere 6% since 1999, while the broad oil-service index OSX has doubled. Why? Until recently, "most major oil companies were forecasting oil prices would settle at around \$20 a barrel," says Stephen Leeb, president of Leeb Capital Management, which owns shares. At that price, the more expensive deep-sea drilling is marginally profitable at best, he notes. With oil now about \$55 a barrel, Transocean, which controls some 40% of

deepwater oil drilling rigs, is starting to get orders, says Leeb. Low demand had discouraged rig builders from investing in new ones, and now "there will be a scramble for the few offshore rigs available," says Leeb. He says day rates are rising, which should mean "fat profits for Transocean." His 24-month stock price target: 60 to 65. He estimates earnings of \$2 a share for 2005—way up from the Street's consensus of \$1.07—and \$4 in 2006, vs. the Street's \$2. Roderick McKenzie of Sterne, Agee & Leach upgraded his rating from hold to buy.

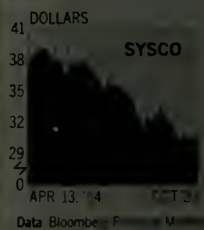
A KILLING FROM DRILLING?



Betting on the End Of the Sysco Skid

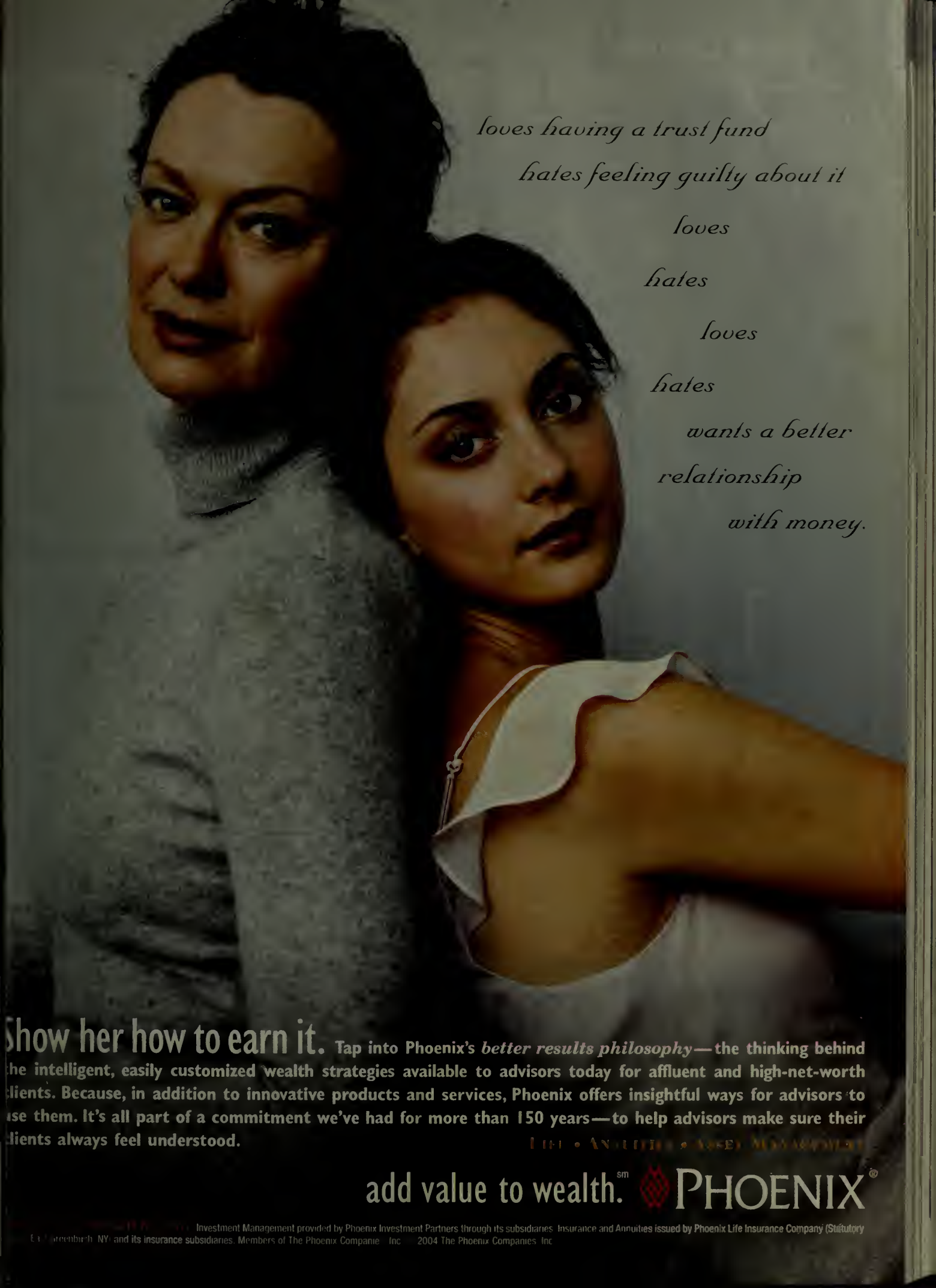
SINCE LATE APRIL, shares of Sysco (SY), No. 1 marketer of food service products such as vegetables, meats, and kitchen supplies to more than 420,000 customers in the U.S. and Canada, have fallen from 40 to 30. The sharp rise in oil prices has jacked up the costs for operating its fleet of 8,500 trucks. Also, demand for its products has weakened due to slow traffic at major customers—mainly restaurants and hotels. But the stock's drop has enticed some value players. Richard Steinberg of Steinberg Global Asset Management, who bought shares, says that as the dominant player in the industry, Sysco has "demonstrated over the years above-average growth and earnings consistency." The stock will easily reach 40 or more, he says—when the economy turns up and oil prices ease. He figures Sysco will earn \$1.54 a share in fiscal 2005 ending June 30 and \$1.75 in fiscal 2006, vs. 2003's \$1.37. Andrew Wolf of BB&T Capital Markets says the near term will be tough, but he thinks the stock, which he rates hold, is fairly valued for long-term investors. ■■

EMPTY-LARDER DAYS



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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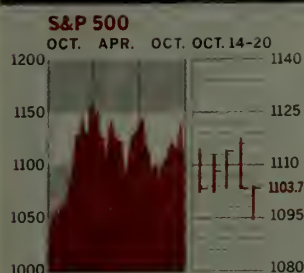
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Personal Business Figures of the Week

STOCKS



COMMENTARY

It was a mixed week for equities, despite strong earnings from such bellwether tech outfits as IBM and Texas Instruments, which reported record results on surging sales of cell-phone chips. Financial stocks fared less well: J.P. Morgan Chase reported a 13% drop in earnings due to merger costs. Uncertainty about the elections and rising oil prices are worrying investors.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	OCT. 20	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1103.7	-0.9	-0.7	5.6
Dow Jones Industrials	9886.9	-1.2	-5.4	1.1
NASDAQ Composite	1933.0	0.6	-3.5	0.4
S&P MidCap 400	586.4	-0.2	1.8	9.0
S&P SmallCap 600	288.9	-0.1	6.8	14.6
DJ Wilshire 5000	10,804.3	-0.7	0.0	6.5

SECTORS

		WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	643.5	-0.8	3.4	6.7
BW Info Tech 100**	335.0	0.9	-4.4	-1.4
S&P/BARRA Growth	536.0	0.0	-3.6	1.2
S&P/BARRA Value	563.6	-1.7	2.1	10.2
S&P Energy	279.6	1.5	24.7	37.9
S&P Financials	370.3	-4.1	-2.5	2.2
S&P REIT	131.3	0.9	13.4	18.5
S&P Transportation	215.5	2.0	6.7	13.1
S&P Utilities	129.0	0.4	9.0	15.6
GSTI Internet	152.1	-0.3	5.1	6.7
PSE Technology	686.8	1.0	-1.5	4.5

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	OCT. 20	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1215.9	2.0	3.2	1.1
London (FT-SE 100)	4616.4	-0.4	3.1	6.1
Paris (CAC 40)	3665.7	-0.8	3.0	1.1
Frankfurt (DAX)	3912.4	-1.6	-1.3	1.1
Tokyo (NIKKEI 225)	10,882.2	-2.8	1.9	1.1
Hong Kong (Hang Seng)	12,970.9	-1.5	3.1	1.1
Toronto (S&P/TSX Composite)	8788.1	0.7	6.9	1.1
Mexico City (IPC)	11,076.9	1.2	25.9	4.1

FUNDAMENTALS

	OCT. 19	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.72%	1.71%	1.62
S&P 500 P/E Ratio (Trailing 12 mos.)	19.3	19.8	28.1
S&P 500 P/E Ratio (Next 12 mos.)*	15.6	15.9	17.6
First Call Earnings Surprise*	2.17%	2.27%	6.24

*First Call C

TECHNICAL INDICATORS

	OCT. 19	WEEK AGO	YEAR AGO
S&P 500 200-day average	1120.0	1119.9	Negati
Stocks above 200-day average	54.0%	60.0%	Neutr
Options: Put/call ratio	0.86	0.84	Positi
Insiders: Vickers NYSE Sell/buy ratio	4.51	4.17	Negati

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Gold Mining	10.7	Oil & Gas Refining	71.9
Fertilizers & Ag. Chems.	8.8	Internet Software	62.8
Oil & Gas Refining	7.8	Fertilizers & Ag. Chems.	61.7
Oil & Gas Drilling	6.8	Internet Retail	61.5
Oil & Gas Exploration	6.6	Steel	59.8

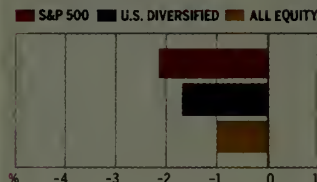
WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Insurance Brokers	-41.7	Insurance Brokers	-40.1
Multi-line Insurers	-17.9	IT Consulting	-31.1
Health-Care Distributors	-16.6	Airlines	-31.1
Tires & Rubber	-14.3	Health-Care Distributors	-29.1
Homebuilding	-12.1	Semiconductor Equip.	-29.1

MUTUAL FUNDS

4-WEEK TOTAL RETURN

WEEK ENDED OCT. 19



52-WEEK TOTAL RETURN

WEEK ENDED OCT. 19



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	5.9	Natural Resources	36.8
Real Estate	3.6	Latin America	29.6
Communications	2.5	Real Estate	25.3
Europe	2.0	Europe	21.3
LAGGARDS		LAGGARDS	
Health	-5.2	Technology	-7.0
Financial	-2.9	Japan	1.1
Large-cap Value	-2.4	Large-cap Growth	1.1
Large-cap Blend	-2.1	Small-cap Growth	1.5

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
U.S. Gl. Invs. Prec. Mnls.	12.5	iShares MSCI Austria Idx.	61.4
U.S. Global Invs. Gold	11.7	ProFunds Energy U.S. Inv.	57.1
Oppenheimer Real Asst. A	9.9	State St. Rsch. Rsres. A	53.8
Midas	9.1	ProFds. Wrsls. Ultsr. Inv.	50.8
LAGGARDS		LAGGARDS	
American Heritage Growth	-14.3	ProFds. Smicdr. Ultsr. Inv.	-43.0
ProFds. Phmcls. U.S. Inv.	-13.3	GMO Emerg. Mkts. Qty. III	-41.3
Fidelity Select Insurance	-10.3	Thurlow Growth	-37.7
ProFds. Hlthcare. U.S. Inv.	-10.1	Ameritor Investment	-31.4

INTEREST RATES

KEY RATES

	OCT. 20	WEEK AGO	YEAR AGO
Money Market Funds	1.29%	1.26%	1.61
90-Day Treasury Bills	1.83	1.71	0.95
2-Year Treasury Notes	2.50	2.49	1.76
10-Year Treasury Notes	3.98	4.06	4.25
30-Year Treasury Bonds	4.77	4.87	5.14
30-Year Fixed Mortgage†	5.62	5.70	5.89

†Barr's Quote, I

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.66	4.17
Taxable Equivalent	4.94	6.41
Insured Revenue Bonds	3.66	4.17
Taxable Equivalent	5.23	6.76

THE WEEK AHEAD

CONSUMER CONFIDENCE

Tuesday, Oct. 26, 10 a.m.

EDT » The Conference Board's October confidence index probably dipped to 94.3, after falling to 96.8 in September. That's according to the median forecast of economists surveyed by Action Economics.

DURABLE GOODS ORDERS

Wednesday, Oct. 27, 8:30 a.m.

EDT » New durable-goods orders for September are forecast to have rebounded by 0.4%, after

a 0.5% decline in August.

BEIGE BOOK Wednesday, Oct.

27, 2 p.m. EDT » The Federal Reserve will release its roundup on regional economic activity ahead of the Nov. 10 monetary policy meeting. Respondents to the latest Action Economics survey expect that at the upcoming meeting the Fed will lift interest rates to 2%, from the current 1.75%.

GROSS DOMESTIC PRODUCT

Friday, Oct. 29, 8:30 a.m.

EDT » The economy probably grew at an annual rate of 4.2% in the third quarter. In the second quarter, growth stood at 3.3%.

EMPLOYMENT COST INDEX

Friday, Oct. 29, 8:30 a.m.

EDT » Compensation in the third quarter most likely climbed by 1%, after a 0.9% increase in the second quarter. Benefit costs, such as health care, should continue to outpace wage gains, driving the overall index higher.

The BusinessWeek production index climbed to 228.5 for the week ended Oct. 9, a 12.5% improvement from year ago. Before calculation of the four-week moving average, the index rose to 230.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.h

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TELECOM 2004

To read full reports and related information, go to the table of contents below or visit www.technology-reports.com

Co-Sourcing: Rethinking how to Maximize Your CRM Investments

How do I leverage my precious investments, keep control of my future strategic and IT directions, while controlling the management and labor costs associated with running an efficient/effective call center?

The Customer Relationship Management and Supply Chain Management solutions that you implemented last year still have not delivered the anticipated returns. You just built a state-of-the-art contact center to integrate the multiple disparate centers that have emerged over the

years and now you are asking yourself, when did we become a customer contact center business?

The decision to have another company manage the relationship with your customers means that you are entrusting the very essence of what makes your company great. You can outsource with a company that acts as a relay or conduit between you and your customers – or, you can have a co-sourced management arrangement with a company who specializes in managing and optimizing your resources thus maximizing the return on your existing infrastructure.



An effective co-sourcing partnership not only impacts the bottom line, but also enables better management of internal resources while leveraging industry best practices.

Many industries, including telecommunications, automotive, financial services, consumer products and the travel industry, have all benefited from co-sourcing while mitigating some of the risks that come from traditional outsourced relationships.

If you're not ready for a traditional outsourcing model because of concerns about technology direction, security, customer data and labor control, etc., but want to take advantage of the cost and performance benefits of working with best-in-class experts, co-sourcing may just be the perfect solution for your company.

To read the full report, go to www.technology-reports.com/faneuil



In today's world of highly competitive and margin sensitive, vendor-centric business relationships, nothing better validates the success of a business partnership than bottom line business results. The Faneuil Group, a leader in customer contact management services, takes that maxim as the foundation for all of its client relationships. For more information about The Faneuil Group's services, contact the North American Sales Team at 866.FANEUIL or www.faneuil.com.

The Enterprise Search for World-Class Telecom Contracts

The pressures placed on enterprises to cut costs and drive margins has never been greater. Securing a world-class telecom contract will provide long term financial refuge for most enterprises. While market leading pricing is fundamental, there has never been more uncertainty surrounding the direction of enterprise technology; elevating the requirement to secure critical contract provisions that address the non-price aspects of supplier relationships.

How does an enterprise

negotiate a contract with best in class pricing and robust contract provisions? The unfortunate truth is that few companies today – less than 5 percent, actually – have successfully negotiated world-class telecom contracts. Research shows that insertion of outside experts

The Continuum of Telecom Agreements
The vast majority of telecom agreements trail the market in economic value and contract terms. Expertise and leverage can move clients to the leading edge of the curve, where they can secure a best-in-class contract.



into the telecom sourcing initiatives has proven to be a successful method used to significantly elevate and accelerate results. Experienced consulting firms that specialize in telecom sourcing provide the missing ingredients that enter-

prises do not possess internally. Knowledge of ever-changing best-in-class prices and deal structures comes from an every day singular focus on driving leading edge deals across scores of procurement situations. The firm's experience allows for effective rapid navigation through cumbersome processes established by industry suppliers while their relationships with the suppliers' senior executives ensure focused attention during and after the sale.

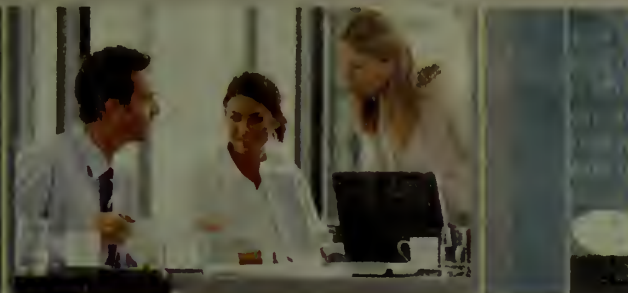
The first step to achieve world-class results begins with a comprehensive validation and strategy assessment. The leading consulting firm offers a no-cost, no-obligation opportunity assessment. This client specific assessment will provide time benchmarking data, define market level and contain strategy recommendations.

To read the full report, go to www.technology-reports.com/telwares



Telwares works with large enterprises to optimally source and manage their telecom investments. This leading consulting firm's first step begins with a no-cost and no-obligation validation and strategy assessment. With focused practices in Voice, Data, Local and Wireless services, Telwares is the trusted advisor to over 200 enterprise clients, including 81 of Fortune 500 and 31 of the Fortune 100. 888.TELWARES • www.telwares.com

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To read full reports and related information, go to the links listed below, or visit www.technology-reports.com

Satellite Communications: Extending Networks to "Hard to Reach Places"

With the ever growing presence of digital mobile phones and wireless Internet access, people have come to expect business class communications just about anywhere. That's fine if you're a road warrior in a coffee shop or hotel lobby; but imagine working in one of the world's most remote locations – a dense jungle, scorching desert, or the open ocean. You are hundreds of miles from the nearest town, far away from the basic necessities of electricity, clean water, or telecommunications. For thousands of companies in industries like exploration, construction, maritime, mining, forestry, and disaster relief, these are the realities of the "daily commute." The broadband telecom

services taken for granted at the corporate office are virtually inconceivable in the harsh environments surrounding these remote operations.

The answer for many companies in hard to reach places is the latest generation of broadband satellite services powered by Very Small Aperture Terminal (VSAT) technology. While the basic technology has been delivering mission critical applications to the retail, banking, and military sectors for nearly three decades, in recent years specialized providers have adapted their satellite services to the "ruggedized" networking needs of remote industrial operations.

Unlike handheld mobile satellite phones, which pro-

vide cell phone like service with limited email and messaging functions, VSAT services provide complete enterprise class corporate networking. Broadband VSAT services combine the power of IP based technology with geosynchronous satellites to deliver multi-line telephone and fax service, secure corporate networking, Internet access, and even real-time video conferencing – all to locations "beyond the edge" of the traditional telecom infrastructure. A remote operation like a ship at sea or oil drilling platform can literally be just another extension on the corporate telephone system and just another IP address on the company's private computer network. The right satellite service provider can reliably deliver the corporate class communications that people and organizations have come to expect, in places that they might not ordinarily expect to find them.

To read the full report, go to
www.technology-reports.com/caprock.asp



CapRock Communications has over 20 years experience delivering enterprise class telecommunications to the world's most remote locations. Through its self owned and operated global satellite network, which includes teleports across the US, Europe, South America, and Asia, CapRock delivers fully managed voice, data, and video solutions around the globe. Customers from a wide range of industries depend on CapRock for highly reliable communications in extreme environments. 888.482.0289 • www.caprock.com

Convergence – The Future of Conference Communications

Converging technologies have become commonplace for business professionals. Gone are the days of carrying around a day planner, an address book, a calculator and a cell phone. Now, more than ever, a single mobile device does it all. The trend toward convergence has recently been moving into the teleconferencing arena. Once stand-alone solutions are becoming integrated, offering users a way to communicate more effectively while reducing the number of services they must employ to do so.

Today's Information Workers are looking for integrated communication and collaboration

solutions that combine instant messaging, audio, video and web conferencing. Delivering these unified communication solutions is key to Microsoft's vision for real-time collaboration," said Anoop Gupta, Corporate Vice President, Microsoft Corp. Work in the direction of this vision is already apparent when one considers the points of conferencing integration currently available in several of the Office applications and the Messenger tool.

More traditional conferencing suppliers also recognize the value that convergence can offer to their client bases. "Customers are demanding tools that allow them to conduct more efficient

and productive meetings," said the president of a leading conferencing service provider. Offering features traditionally associated with an audio conference in tight integration with the online interface used during a web conference, or bringing video images into that same screen can provide the streamlined meeting experience upon which conferencing customers are insisting.

As this trend continues to produce converging conferencing technologies, business professionals will be able to adopt single conferencing solutions or platforms and select the features – audio, video or web-based – that allow them to communicate with their cohorts, customers, employees and other points of contact in the manner most suited to the message at hand.

To read the full report, go to
www.technology-reports.com/intercal.asp



InterCall, the largest conferencing services specialist in the world, proudly offers Conference Place, powered by Microsoft Office Live Meeting. Conference Place is an integrated web and audio conferencing solution that enables online communications between meeting leaders and remotely located participants. Conference Place is a great example of how converging conferencing technologies can help make business communications more efficient and effective. To see a demonstration, visit www.conferenceplace.com/bw04.

TELECOM 2004

To read full reports and related information, go to the links listed below or visit www.technology-reports.com

PON: Big Bandwidth for Small Business

Passive Optical Networks (or PON) bring the promise of tremendous amounts of telecommunications bandwidth to small- and medium-sized businesses. PON-based architectures overcome the critical last mile hurdle and deliver hundreds of Mbps of capacity at costs that rival traditional T1 services. Businesses now have, on a single network, enough bandwidth and speed to handle all their local and long-distance telephone services, and high-speed Internet, E-mail, video and data needs.

A PON-based service is delivered over a fully fiber optic facility with only the two end points

having active electronic components. Network service reliability is superior to the old TDM (Time Division Multiplex) networks, which are based in large part on copper facilities with many active electronic components arrayed in the network. Standard IP Ethernet technology serves as the backbone protocol used to communicate between endpoints. Network managers can easily manage the health of the network and the services being provided, all the way down to specific ports attached to customer equipment.

Based on their needs, companies can expand and customize their PON-based, all-digital net-

works within hours of a newfound requirement. If an Internet connection is needed with multiple Mbps of service, the customer subscribes the appropriate bandwidth using the Ethernet connections on the PON router installed at their location. Up to 100 Mbps of service can be delivered over a single interface, at costs lower than T1 (DS1), DS3, or SONET services connections. Traditional TDM interfaces such as a T1 interface are available for telephone and other applications that may demand this type of connection.

Simple to Manage, Simple to Use, Unbeatable Cost Performance – PON-based services are winning the day for small- and medium-sized businesses.

To read the full report, go to www.technology-reports.com/knology

KNOLOGY

Knology Inc. (NASDAQ: KNOL) is a leading provider of interactive communications and entertainment services in the Southeast. Knology serves both residential and business customers with one of the most technologically advanced broadband networks in the country, supplying voice, video and data services. Knology's fiber-based business products include Passive Optical Network (PON), and Managed Integrated Network Solutions (MATRIX). 678.870.1207 • www.knology.com

VoIP: Compelling Applications Begin to Drive Rapid Adoption

Voice over Internet Protocol (VoIP) is all about doing more with less: more communication with less expense, more functionality with less maintenance and more productivity with less resource. This phenomenon is driving the rapid adoption of VoIP for enterprises around the United States.

VoIP dissolves the traditional circuit-switched categories of local, long distance and international communications, integrating all voice communication, along with data, over a single connection to the service provider. The benefit is greater network efficiencies and lower cost for the enterprise. As a result, innovative pricing structures

such as "all distance" calling throughout the U.S., Canada and even parts of Europe have emerged.

VoIP also means new capabilities. The conversion of voice communication into IP packets enables software manipulation of the packets as though they were data. This enables "virtual" services so that businesses can get full PBX functionality with no premise-based system to manage, other than the phones themselves. This greatly reduces capital outlay and the overall burden of system management and operation. In a wireless office environment, an IP phone becomes another mobile object identified centrally on the network, operative anywhere on the premises, and at anytime.

Businesses can now provide greater flexibility to teleworkers and mobile staff by providing integrated access to voice and data applications. By providing employees access to VoIP, any business can immediately change the size, location or hours of operation of their workforce. Employees can get voice communications with all PBX features, as if they were at their office, while accessing data applications using Virtual Private Networking. And best of all, they can have these benefits from anywhere there is a broadband Internet connection.

Between the efficiencies gained in network management, the telecom cost savings, increased feature, functionality and increased productivity, businesses that embrace and adopt VoIP are finding they have the advantage over the competition.

To read the full report, go to www.technology-reports.com/startec

startec

GLOBAL COMMUNICATIONS

Startec Global Communications is a leading integrated communications provider serving businesses and consumers in North America and Europe. The company operates its own state-of-the-art global IP network. Startec offers business customers a full suite of voice, data and Internet communications services. Startec has approximately \$100 Million in annual revenue and is owned by Allied Capital (NYSE: ALD) and GE Capital (NYSE: GE). For more information, call 301.610.4340 or visit www.startec.com

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VoiceXML: Saving You Money While Simplifying Your Life

There has been a lot of buzz around VoiceXML in the last couple of years, but now this standard is demonstrating, daily, its value in enterprise voice applications. VoiceXML is finally poised to help the bottom line.

Just as HTML revolutionized the business world by making Web applications easy to create and control, VoiceXML is positioned to do the same for voice applications. VoiceXML, based on XML, is an open-standard language that allows you to voice-enable your business applications. Whatever business tools you want to make accessible to your customers over the telephone, VoiceXML simplifies

and standardizes the development and provides greater flexibility for deployment. For example, you might want to allow your customers to access their account balances, schedules of events, or directions to your facility over the phone. The value that VoiceXML adds to your business is that speech applications like these are no longer locked into a proprietary environment. VoiceXML puts you back in control over the vendor relationships. In the past, making changes to a proprietary infrastructure was prohibitively costly. Today's standards-based systems make it easy to change, update, or add new components and features.

Arguably, the biggest value that VoiceXML brings is the ability to get your solution up and running faster, and with less risk by leveraging a hosting company. Outsourcing the infrastructure takes away the stress of operating and maintaining an in-house platform. Moreover, deploying your applications on a hosting company's platform built on VoiceXML and other open standards significantly increases your speed to market while saving your company millions in capital expenses. You still maintain your flexibility and control, but you don't risk the huge capital expense to get it. Instead, your voice applications take advantage of a reliable, consistent environment that is operated, monitored and maintained by experts in the industry.

To read the full report, go to
www.technology-reports.com/cpt.asp



CPT International Inc. is a telecom services provider located in Marietta, GA. The company's flagship offering, Voice Harbor, provides standards-based hosting services for VoiceXML, speech, multi-modal and traditional telephony applications. Voice Harbor brings flexible call capacity, predictable costs and rapid deployment to customers and partners seeking to outsource voice application infrastructure. For more information, visit www.cptii.com.

Leveraging Voice Over IP for Tangible Business Results

Over the past few years, it has become increasingly more important for businesses to leverage technology to run efficiently and cost effectively. We've started to see in 2004, Voice Over IP solutions are allowing leading companies to trade traditional PBX systems for Internet Protocol (IP) systems.

Hosted IP voice services (also known as IP Centrex) move the PBX telephone system out of your office and onto a managed subset of the public Internet, which can dramatically reduce your company's total cost of ownership while maintaining enterprise-class reliability.

By eliminating the need to purchase PBX hardware, hosted IP solutions minimize up-front and ongoing capital expenditures. Hosted IP systems can also significantly reduce annual operating costs by linking numerous remote locations into a single centralized system with a simplified web-based interface to manage moves, adds, and changes. Because there is no system to buy and all software and hardware upgrades are managed by the service provider, there is also a reduced risk of technology obsolescence.

In most companies with fewer than 1000 employees, the decision to move to a hosted IP

system can lead to annual savings of up to 30%, with full payback in 12-18 months. Add in free local and on-net calling, 4-digit dialing, unified messaging, voice/web conferencing, plus employee productivity improvements, and the move quickly translates into a positive ROI. All of this for a basic business service that starts as low as \$20 per month.



To read the full report, go to
www.technology-reports.com/gphone.asp



GlobalPhone is a facilities-based carrier providing telecom solutions to 600,000 customers in over 130 countries using its state-of-the-art TDM and Voice Over IP network. GlobalPhone maintains business relationships with many of the world's top carriers, and provides its award-winning GlobalToneSM hosted IP Centrex services through the Level(3) Enabled Partner Program. Falls Church, VA • 800.705.5033 • www.gphone.com/globaltone



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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Why Insurance Needs a Cleanup

WE HATE MOST REGULATION. But even more, we hate corrupt, unethical business people and professionals who bring it down upon us. Bid-rigging, price-fixing and payoffs—the charges leveled against Marsh & McLennan Cos. and some of the nation's largest insurance companies by New York Attorney General Eliot Spitzer—are not only civil offenses, they are crimes against capitalism. They prevent competition, erode market efficiency, and raise costs. They destroy public trust by hindering transparency and the free flow of information. The egregious behavior of people who game markets, create conflicts of interest, and deceive shareholders inevitably invite government regulation. Ironically, it is Corporate America that is the greatest victim of the insurance scandal now unfolding. Chief executives should not hesitate to support New York and other state regulatory agencies in cleaning up the insurance markets.

They should also throw their support behind efforts to create a national standard for insurance practices. Unlike banks and the rest of the financial system, insurance is not regulated by Washington but by 50 state insurance commissioners under 50 sets of laws and 50 sets of rates. A

congressional bill, dubbed SMART for State Modernization & Regulatory Transparency, could provide uniform standards.

But that isn't nearly enough. A three-month investigation by *BusinessWeek* into Marsh & McLennan reveals a secretive arrogant corporate culture, largely hidden from public and client view (page 71). A business model based on alleged conflicts of interest, such as steering unsuspecting clients (who pay Marsh for best prices and policies) to certain insurance companies (who pay Marsh to go in business), appears to have generated much of the insurance broker's 2003 earnings. Spitzer is also probing Marsh McLennan's pension-consulting arm, Mercer, to see if it pushes clients into buying Marsh McLennan

Marsh took payoffs for steering clients to insurers, Spitzer says

insurance products. The Securities & Exchange Commission is investigating Mercer's practice of requiring payments from money managers who want to be recommended to pension clients. The SEC is also looking into whether executives at Putnam Investments, Marsh McLennan's mutual fund company, made payments to companies to have its funds featured in 401(k) plans. These suggest a corrupted corporate culture that requires change at the top.

In response to the Spitzer charges, CEO Jeffrey W. Greenberg announced that he was appointing a private investigator to look into the alleged insurance broker fraud. He gave the job to the head of Kroll Inc., owned by none other than Marsh & McLennan itself. The very same day, Greenberg appointed the same man as the head of Marsh, the insurance brokerage unit. It's time for a new CEO.

The Stalling of Motor City

WHERE IS DETROIT? The last time energy prices shot up unexpectedly, in the 1970s, it was Japan that led the way with profitable, fuel-efficient small cars. Detroit never did figure out how to make them and chose, instead, to make big profits off low-mileage, gas-guzzling SUVs. Now, oil futures are predicting high-priced gas for years to come, and Japan is again out front with innovative vehicles—fuel-efficient, electric-gas hybrids.

When will Detroit learn? Certainly Ford gets it. It has a hybrid on sale right now, the crossover Escape SUV (based partly on Toyota Motor Corp.'s hybrid engine technology), and

plans to sell about 45,000 over this year. But neither General Motors Corp. nor DaimlerChrysler Corp. will introduce a single hybrid any time soon and their offerings will be slim for years to come. In the meantime, Toyota and Honda Motor Co. are starting to flood the zone with tens of thousands of different hybrids. The Prius is hot, and Toyota will soon bring out a hybrid version of its Lexus RX and Highlander SUVs. Honda will launch a hybrid version of its popular Accord in December. Booz Allen Hamilton Inc. estimates that hybrids could make up 20% of the entire U.S. market by 2010. Detroit argues that you can't have mileage efficiency without giving up performance and luxury. Japan is proving just the opposite. Toyota's Lexus RX will have 270-plus horsepower and better than 27.6 mpg—the current average of a compact sedan (pages 40 and 114).

Detroit is way behind because it hasn't invested. True, it has enormous legacy costs from retired workers and huge benefit costs from current employees. But managerial shortsightedness is what's hurting the industry most. The Japanese are on their third generation of hybrid-powered cars. Detroit is barely on its first. As production is ramped up, costs will fall and profits will rise. Hybrids are a technological breakthrough for the Japanese. Unless Detroit invests in innovation, it risks falling behind once again. How sad.



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**SH MAC
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INVENT IT?**

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**ELLITE
DIO
LIT EVER
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RY
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YOUR NEW HEALTH PLAN

HEALTH SAVINGS ACCOUNTS, like 401(k)s, will give employees more choices—but also a greater share of the costs. **BY HOWARD GLECKMAN (P. 88)**



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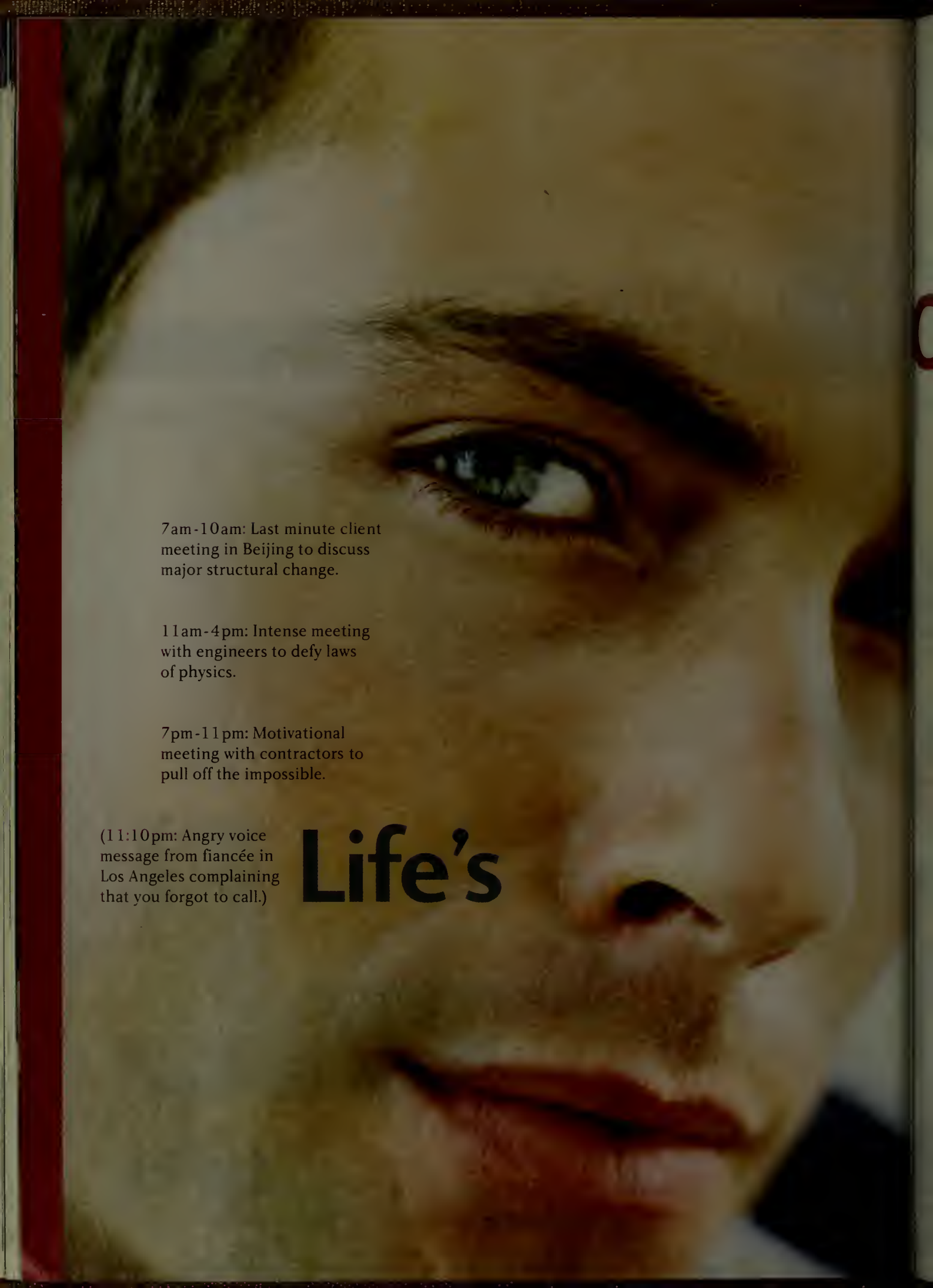
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7am-10am: Last minute client meeting in Beijing to discuss major structural change.

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7pm-11pm: Motivational meeting with contractors to pull off the impossible.

(11:10pm: Angry voice message from fiancée in Los Angeles complaining that you forgot to call.)

Life's

(11:15pm: Call to fiancée to show
her you never stopped thinking
about her for a second.)

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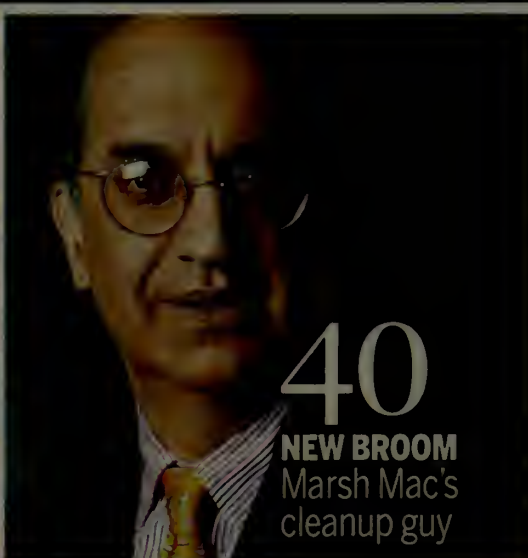
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A Double Bind for E-tailers

As competition gets stiffer on the Internet, growth rates for sales and new shoppers are beginning to slow at some major online shopping sites, leading Wall Street to exact a tough punishment

Technology Special Report: A New Generation of Visionaries

These folks are a little older and more experienced than back in the '90s heyday. However, they're just as inspired and determined. Plus: Championing a Wiki world, and a new travel search site that may go far

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Will the policies of a Bush or a Kerry Administration make much of a difference for the economy or the markets over the next couple of years? Not likely. From oil prices to market cycles, S&P analysts look at the forces the next President must deal with

Economic Futures: China's Coming Financial Crisis

Thanks to its quasi-socialist government, the budding superpower is ill-equipped to handle a bust, says BW Chief Economist Michael Mandel

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A photograph of two Arsenal football fans celebrating. They are standing on a dark, silhouetted structure, possibly a goalpost or stadium architecture, against a clear blue sky. The fan on the left is wearing a grey and white Arsenal kit, while the fan on the right is in a red Arsenal kit. They are both holding a large Arsenal flag with a red and white checkered border and the Arsenal crest. The word 'Arsenal' is written in white on the red background of the flag. The fan on the right has 'O2' written on their red kit. The overall mood is one of joy and triumph.

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The Progress Energy Leadership Institute provides leadership development opportunities for principals and superintendents.

JP Front

"What little we do know [about hedge funds], at least to me, has alarm bells ringing."

—SEC Commissioner Harvey Goldschmid on the move to regulate hedge funds

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MOVIE DEALS

FIRST BLOOD IN THE NEXT-GEN DVD WAR

FOR MONTHS, Toshiba and Sony have battled over the next generation of DVD. Now Toshiba may score an early victory, *BusinessWeek* has learned. Warner Bros., Universal, and Paramount are expected to announce soon that they'll release movies on

seen as crucial in enticing consumers to replace old DVD players with new high-def ones. The studios and Sony declined to comment. Toshiba acknowledges a "positive response from several studios," declining further comment.

Both formats provide sharper pictures and vastly increased storage space. But Blu-ray DVD production requires new plants and equipment, so it's initially costlier than the Toshiba version, which mostly uses existing DVD technology.

Sony, which is pushing Blu-Ray with other computer and electronics companies, can count on its own film studios and MGM, which a Sony-led consortium is buying. But a format war isn't great for Sony: In a 1990 fight with Toshiba, Sony failed to get most of its technology into the current DVD. And remember Sony's Betamax in the '80s?

—Ronald Grover



HIGH DEF
Al Pacino
in Ronin

Toshiba's high-definition DVD format by late 2005. It's not an exclusive deal, but it would be a severe blow to the Sony-backed format, Blu-ray. Hollywood movies are



HALLS OF IVY

Harvard: Tops in ... Engineering?

AS PART OF LARRY SUMMERS' GRAND PLAN to reshape Harvard University for the 21st century, the president wants to create a school of engineering with the same status as its prestigious business and law schools. "Technology is so central... [to] what's shaping our world today," he says (Q&A with Summers, page 73).

That would be a big change for Harvard, where engineering has been something of an academic backwater. But at the division of engineering and applied sciences (DEAS), for now part of the Faculty of Arts & Sciences, plans are being developed to nearly double the number of full-time-equivalent faculty to 100. That would be on par with top engineering programs at Princeton University and the California Institute of Technology, though far smaller than neighbor Massachusetts Institute of Technology.

Rather than all-encompassing, a Harvard engineering school would focus on "the cutting edge in certain disciplines," says DEAS Dean Venkatesh Narayanamurti. Among them: information technology, bioengineering, and nanotechnology. Summers says the new school would likely be based across the Charles River near the B-school campus: "There is an enormous two-way fertilization there," he says. A plan could be ready in months.

—William C. Symonds

EVALUATIONS

FAMILY FORTUNE With their companies under regulatory scrutiny, the Greenbergs have seen the value of their equity stakes take a dive:



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AN GREENBERG
(Left) President and CEO, Ace Ltd.

-\$303mil

HANK GREENBERG
(Middle) Chairman and CEO, American International Group

-\$13mil

JEFF GREENBERG
(Right) Ex-Chairman and CEO, Marsh & McLennan Cos.

UP Front

PC PATROL

DUDE, YOU'RE GETTING A DELL PLANT

DELL'S RELENTLESS efficiency has forced most rivals to move manufacturing jobs overseas just to keep pace. But now the king of all PC makers is using its clout to wrangle tax breaks to expand its operations at home.

On Oct. 19, Dell CEO Kevin Rollins told **CNET.com** he expects to announce plans in the next several weeks for a new U.S. factory that will

assemble PCs and other products for customers in North America. The leading contender: North Carolina, which is hoping the plant's 1,900 jobs, mostly paying around \$12 an hour, will offset job losses in the tobacco, textile, and furniture industries. State and local officials are said to be mulling tax breaks and incentives worth more than \$100 million. Rollins won't discuss specifics, but says the reports are "more accurate than not."

Dell is getting a lot of financial aid from communities desperate for new jobs and tax revenue. Officials in Oklahoma are hammering out incentives for Dell to build a call center, which could include a 60-acre swath of riverfront property in Oklahoma City. And on Oct. 11, Dell won \$8 million in incentives for a distribution center in West Chester, Ohio. Not a bad deal for either side, so long as Dell keeps on dominating. —Andrew Park



BRANDING BATTLES

TUG-OF-WAR Some business tiffs still get settled the old-fashioned way. Kayak suppliers Harmony and Werner Paddles came to a recent trade show each introducing a new paddle called Cascadia. "People asked: Are you going to fight it out?" says Joe Pulliam, a vice-president at Harmony's parent, WaterMark Sports. Not quite. **He challenged Werner President Bruce Furrer to a paddle-off.** Two kayakers were tied together in a demo pool. After some fierce paddling, Furrer dragged Pulliam to one end. A gracious victor, Furrer says: "It's really nice to talk, instead of the first call being to the lawyer." Harmony renamed its paddle Tortuga, without a court battle. —Brian Hindo

OVER THERE AMERICA'S FRENCH CONNECTION

FRANCE AND THE U.S. may disagree on many things, but making money isn't one of them. The U.S. continues to be the biggest foreign investor in the French economy. During the first half of 2004, U.S. investment in France hit nearly \$4.5 billion, up from \$1.5 billion in all of 2003, according to **A.T. Kearney's** annual survey of foreign investment.

The cash infusion was responsible for nearly a fourth of the French jobs related to foreign investment. That *je ne sais quoi* in the French economy? It's money from the U.S. —Louis Lavelle

DRAWN & QUARTERED





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FACE TIME

DURK JAGER



AFTER P&G, FINDING A BETTER FIT

Durk Jager resigned under pressure as Procter & Gamble's CEO in 2000 amid criticism that he launched too many new products too fast. One such product, Fit Fruit & Vegetable Wash, was canned by successor A.G. Lafley. Now Jager, 61, is reviving Fit, which removes contaminants that water alone does not. He's an investor and adviser to HealthPro Brands, a Cincinnati startup formed in 2003 to market Fit.

Jager, who sits on four boards, including Eastman Kodak and Chiquita Brands International, says Fit's prospects are better now that it's the sole focus of one company and is in a dozen national and regional supermarkets and 200 independents. "Sometimes you're before your time," he says, noting that awareness of food contaminants has grown.

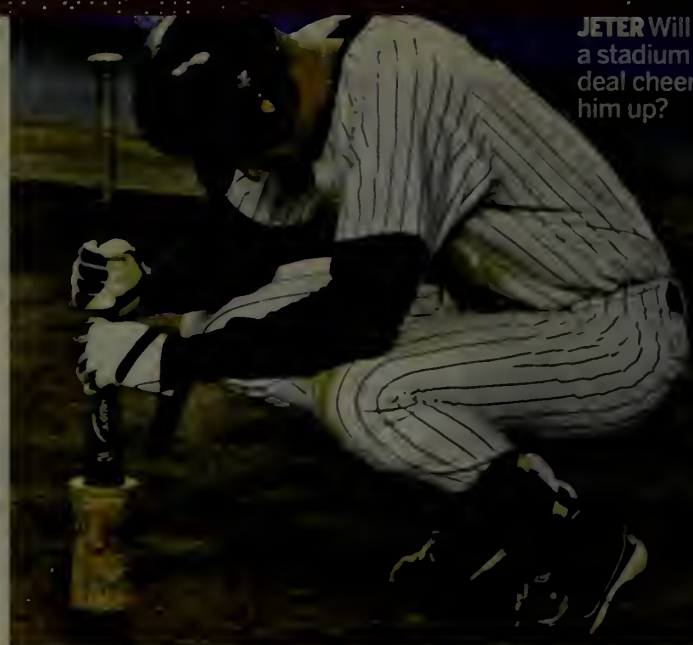
Jager denies any sentimental attachment to Fit given its P&G history: "I don't spend money on things that are emotional." But no doubt he would like to prove P&G wrong. —Robert Berner

SPORTS BIZ

FOR THE TEAM THAT HAS EVERYTHING...

THE NEW YORK YANKEES may have suffered a humiliating collapse in the American League Championship Series, becoming the first baseball team to blow a 3-0 lead in a best-of-seven series. But the team hasn't lost its formidable financial advantage over the victorious Boston Red Sox and every other team. Owner George Steinbrenner is preparing to increase the Yankees' lead by building a new ballpark, with a big assist from baseball's other clubs.

Currently, the Yankees—with the biggest revenues and the biggest payroll of all Major League Baseball clubs—chip in about \$60 million a year to a revenue-sharing pool for poorer franchises. But per MLB rules, the Yankees will be allowed to deduct their entire cost to construct a new stadium in



JETER Will a stadium deal cheer him up?

the Bronx—estimated at \$700 million of private funding—from their local revenues, where the revenue-sharing money comes from. Since baseball requires teams to share 34% to 38% of their local revenues each year, that means the Yankees could save some \$250 million in revenue-sharing over a decade.

Plus, the increased concessions, sponsorships, and luxury seating the new stadium will bring will boost the Yankees' yearly stadium revenues by at least 25%, says Marc Ganis, President of SportsCorp, a sports-industry consulting firm in Chicago. The new park—final plans for

which are expected by yearend—will only help cement the Yankees' status as baseball's richest club when it opens later this decade. Meanwhile, the rival Red Sox MLB's second-richest, are stuck trying to wring out more cash by updating Fenway Park, the oldest and smallest in the league.

Of course, as the Yankees have just proved, money can't buy a championship. But it boosts the odds that the club will continue qualifying for the postseason, as they have for 10 straight seasons. For Yankees fans, it's something nice to think about during what will surely be a long winter. —William C. Symonds

BOARD GAMES

DOES THE BUCK STOP AT DIRECTORS?

SHAREHOLDER activists say it's almost impossible to get rid of bad directors. Maybe not. New research from University of Chicago accounting professor Suraj Srinivasan



suggests they may pay a price for messing up.

He studied 304 companies that restated earnings from 1997 to 2000. At the 201 that revised earnings downward, half of the outside directors left in three years. Far fewer left at the 103 that made upward or technical revisions.

Critics say Srinivasan's findings don't apply to transgressions such as excessive pay and that many factors affect board turnover.

Srinivasan says restatements exact a "reputational penalty" on directors. Still, only half ultimately left their boards. That means half are still around. —Louis Lavelle

THE STAT

13

Estimated millions of dollars women didn't spend in an Oct. 19 "boycott" protesting the gap between their buying power and their presence in boardrooms and executive suites.

Data: 85 Boards

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The Great Innovators

CELEBRATING



As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

Spinning the World's Web

ALL TIMOTHY J. BERNERS-LEE wanted at first was a simple computer program that could tie figurative reminder strings on his fingers to help him remember associations. In 1980, while working at Cern, the European Organization for Nuclear Research near Geneva, the British-born computer scientist was

having trouble keeping track of which computers Cern physicists were using to analyze what experiments. Then he decided to extend the virtual memory links hither and yon to Cern's 5,000 researchers—and then to anyone with a computer anywhere. His simple program was the Big Bang that exploded into the World Wide Web, launching a still-unfinished revolution and touching countless lives.

Until the Web made its debut in 1991, though, most people had a tough time grasping the need for such connectivity. Even Cern management was skeptical. Today, muses Berners-Lee, what's hard to explain is why the concept ever seemed abstruse.

Perhaps the same will prove true for his encore effort. As head of the World Wide Web Consortium, based at Massachusetts Institute of Technology, Berners-Lee is coordinating a global team bent on hatching the Semantic Web. As the name implies, the new Web will help computers understand one another automatically. With it, machines will do at electronic speeds many chores that now require a human. They'll be armed with tools that enable them to follow links independently and extract information from disparate databases, spreadsheets, and digital images.

The Semantic Web works, says Berners-Lee, by describing people, objects, and events in the real world "and then explaining to the computer how the data relate to those things." For example, cancer researchers will be able to dispatch programs that cross-correlate all relevant data on the new Web, including information stored in incompatible

It's hard to imagine now, but pre-1991, few grasped the potential of connecting everyone everywhere

chemistry and physics archives that doctors and biotech researchers may have never seen. But Berners-Lee admits that selling this vision has been difficult.

Discovering what drives Berners-Lee can also be a challenge, in part because he is notoriously protective of his privacy. Clearly some of his choices were idealistic. In 1990 at age 35, he chose not to patent his Web software. (Doing so might have made him—not Bill Gates—the world's richest person.) Berners-Lee worried that if the Web were based on proprietary software, it would trigger the development of many other web by the likes of Microsoft, IBM, and Apple Computer. If they weren't compatible, his

vision of connecting everyone everywhere would go nowhere.

Entrepreneurs who cashed in on Berners-Lee's brainchild—folks such as Jeffrey P. Bezos of Amazon.com—have long said that their benefactor deserves a juicy reward. He finally got it last June. A week after his 49th birthday, Berners-Lee went to Helsinki to collect 1 million euros, or \$1.2 million, as the first winner of the Millennium Technology Prize. Funded by Finland's government and industry, the award honors achievements in technology, since there is no Nobel prize for engineering or computer science. In Helsinki, Berners-Lee modestly explained that the Web is a composite of lots of existing things, to which he contributed only a wee bit.

Maybe. But that bit brought the world a lot closer together. ■

—By Otis Po



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BusinessWeek

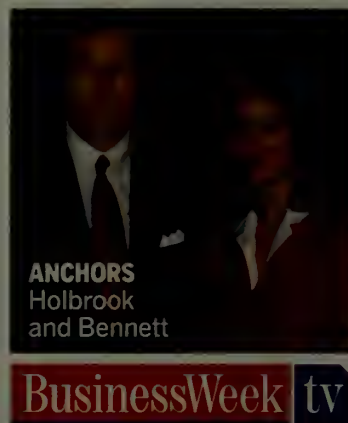
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Readers Report

“Too few [MBA graduates] are willing to pay their dues and learn the business from the ground up.”

—Albert B. Albrecht
Richmond, Ind.



You must be talking through your hat to think that only serious academicians are capable of understanding theory well enough to teach. In my MBA experience the main difference—PhD holders have more and deeper knowledge about what's researched, which concept and who wrote what—hardly matters. I would take the practice-oriented MBA graduate to run my company any time and be content to hire the academically finessed MBA for the analytical jobs.

—Vincent Ricasi
New York

A REPORT CARD ON BW'S B-SCHOOL COVERAGE

RE “THE BEST B-SCHOOLS” (Cover Story, Oct. 18): Ultimately the best companies can be measured by one metric: total return to shareholders as determined by stock price performance and dividends. I would suggest that business-school rankings, as determined by students and the market (e.g., companies) can likewise be simplified into one metric each: a ranking based on which schools prospective students are choosing to attend, and which graduates the market is choosing to compensate the most. These are the schools and graduates most in demand, and therefore these business schools should be ranked the highest.

—Ken Hubbs
Newport Coast, Calif.

I'M NOT SURE that the ranking of a business school guarantees that the graduate will make a good manager or chief executive. I find it hard to believe that an MBA graduate is prepared to start at the top and worthy of a \$135,000-\$150,000 starting salary. Too few are willing to pay their dues and learn the business from the ground up. I wonder how many would be willing to start at \$45,000 in a shop running a computer numerical control (CNC) machine or on an automotive assembly line to learn what manufacturing is all about.

If recruiters pay the salaries quoted in your article for people who have no experience, background, or specialization in the business they are about to become a part of, no wonder they feel they're worth \$1.5 million as a CEO. Something is wrong with the system. It further spreads the gap between the privileged MBA of the top 20, and the middle working class.

—Albert B. Albrecht
Richmond, Ind.

THE COMMENTARY “Too much of a good thing” seems to view the use of ad-

junct faculty as a degradation of the quality of education. Adjunct faculty bring in a much-needed contemporary and real-world context to the academically stale and sometimes impractical orientation of subjects that are taught by full-time professors who likely have gone from college to doctoral school with only a few years of consulting experience to back them up. Keep in mind that the MBA is not a theoretical justification; it is a professional degree where context and perspective from the real world rate higher than conceptual elegance or even mental rigor.

AS A MEMBER OF the class of 2004 (I'm currently taking my last MBA class at DePaul University, Chicago, finishing in November), I was disappointed that you excluded part-time business schools from your biennial B-school survey. We might not have the same reputation or high GMAT scores as our local siblings, i.e., Kellogg and University of Chicago, but we still have many talented students and a great faculty.

Unlike full-time MBA grads, we don't put aside our jobs, careers, and families to take the time to finish our degree. We go to work in the morning and then take

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classes at night, which for some is an even greater effort than being a full-time student. A short comparison/survey of part-time MBA programs might draw some recruiters to our campuses. It would also acknowledge many talented individuals who are as successful and

CORRECTIONS & CLARIFICATIONS

The Economic Viewpoint column by Glenn Hubbard ("When it comes to jobs, Kerry is way off base," Oct. 25) mistakenly stated that "the 4.8% growth in real gross domestic product over the past 12 months is faster than in any such period during the Clinton years." In fact, the GDP growth rate from the second quarter of 1999 to the second quarter of 2000 was 4.85%, compared with a 4.83% GDP growth rate over the last four quarters.

"Tech's future" (Information Technology, Sept. 27) incorrectly stated that Dell Inc. had withdrawn from the consumer PC market in China. It should have said Dell had backed off from the low end of the consumer market in China.

possess as great a potential as full-time MBA grads.

—Oren Orkin
Chicago

Editor's note: While we do not rank part-time MBA programs, we profile more than 280 part-time MBA programs online at businessweek.com/bschools

MORE THOUGHTS ON AN INNOVATION ECONOMY

RE MICHAEL J. MANDEL'S "This way to the future" ("The innovation economy," Oct. 11): I have serious doubt, though I hope for the best, that "all the right factors are in place" for the next 75 years to be as innovative as the last 75. On the list "Where changes were explosive" in the past 75 years, it appeared to me that all of these inventions were made from 1930 to 1950, the remaining years being mainly a time of development and broadening the range of applications to other fields. Jet planes, radar, computers, atomic energy—even the concepts of lean management and supply chains—are all linked to moments in history of strong need.

In a global economy, moments of need grow out of an increasing gap between

the quality of life in separate regions, thus explaining how tech advancement is so much faster in Asia than in the U.S. Technological advances are always balanced with general quality of life: Where we have high quality, we need little advancement, and vice versa.

—Benedikt Westrick
Bologna, Italy

GRIPING ABOUT THE lack of enough science and technology students seems to me a little overblown. What is important is not technology and science per se. We benefit only from technologies that make our societies wealthier and that make more people live better lives. Why was the U.S. the fastest-growing economy during the golden years, from the mid-19th century to the 1930s? Did it have better technology than Britain or other Western European countries? Not exactly. What the U.S. had was a more open economy, entrepreneurial spirit, and propensity to take risks—the main ingredients essential to the ultimate social prosperity.

As long as the market is left to its forces, all comes to its right place through the free flow of people, capital, ideas, and comparative competitive advantages. Maybe it's not competitive any longer for the U.S. to produce more engineering and science graduates. They start to be produced in abundance and cheaply by India, China—and why not Vietnam or Iran? Left alone, the market knows better.

—Momchil Tsonev
Sevlievo, Bulgaria

ALTHOUGH IT MAY motivate some, money is not the key to innovation. It always was, and always will be, passion. Louis Pasteur didn't develop vaccines to get rich, but first of all to help people. Other examples are easy to find. What could threaten the U.S. as an innovator would be too much greed and a lack of passion. Look in your heart to see where you can help people. The money will follow. And as history has proved, maybe somebody else will enjoy the fruits of your work—which is easier to accept if you're not in it for the money.

—Ronny Goedemond
Turnhout, Belgium

"ARE COPYRIGHT WARS chilling innovation?" makes some good points. But as hard as organizations such as the Recording Industry Association of America may work at prosecuting U.S. citizens under American laws, software that works around almost any copy-protection scheme is posted on uncountable Web

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Readers Report

sites around the planet. All this enforcement of the Digital Millennium Copyright Act does is drive that kind of development offshore. It doesn't prevent it. Movie and recording studios need to get over that fact and figure out how to make the new business model work for them.

—Todd Maddison
Oceanside, Calif.

IT IS IMPORTANT to understand the structural changes in venture capital. During the 1970s and '80s, VCs were financial partners to business entrepreneurs, aligned around win-win deals with shared risks. VCs were mature individuals, often with a strong business background. Many of today's VCs are young MBAs with little or no experience in creating and building successful businesses. Today's deals are purely financial arrangements much closer to the commercial-banking model, with disproportionate risk carried by entrepreneurs. The good news is that several of the more established VC firms have returned to fundamentals. They are making thoughtful investments around sound leadership and management and will support the long-term building of strong market franchises. We truly need them.

—Frank Zenie
Hopkinton, Mass.

"THIS WAY TO THE FUTURE" listed natural-gas-powered turbines as one area where innovation has been slow. I beg to differ. In the 1960s gas-turbine efficiencies were below 40%. Today high temperature combined-cycle gas-turbine generators have a heretofore impossible thermal efficiency of 60%—the largest single gain since James Watt's work with steam engines in the 18th century. A plant using what General Electric Co. calls their "H Turbine" system became operational near Mason City, Iowa, this last summer.

—Fred W. Hallberg
Janesville, Iowa

GETTING ON THE ROAD TO GRID COMPUTING

IN "GETTING A GRIP on grid computing" (Information Technology, Oct. 18), Steve Hamm makes an important point: The true business value of grid computing lies in its impact on key applications. This means that grid comes first, and utility will follow. Platform Computing and other members of the Global Grid Forum (GGF) are working with hundreds of customers worldwide to get them on the road to grid by providing them with a roadmap for making the

technology work today and scale for tomorrow. The truth is that vast amounts of computing capacity within a typical existing technology infrastructure remain untapped.

Smart organizations realize that grids are built, not bought. Corporate users must set a long-term strategy, identify specific application opportunities for grid today, and plan the incremental implementation that will bring them to true utility in the future. Much in the same way as consumers are now more confident in their use of the Internet, widespread recognition of the benefits of grid computing will take it to the next level of adoption.

—Songnian Zhou
Founder and CEO
Platform Computing
Markham, Ont.

Editor's note: The writer is a commercial pioneer of grid computing.

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Books

Redefining Smart

ON INTELLIGENCE How a New Understanding of the Brain Will Lead to the Creation of Truly Intelligent Machines

By Jeff Hawkins with Sandra Blakeslee; Times Books; 261pp; \$25

Conventional wisdom is a red flag to Jeff “Trip” Hawkins: By defying it, he has achieved spectacular success. As the founder of two groundbreaking technology companies, Palm and Handspring, he virtually created the era of hand-

held computers with the launch of the first Palm Pilot in 1996. The wealth he accumulated as a result—over \$100 million—allowed him to follow a similar iconoclastic approach in tackling his greatest passion: the study of the brain.

The result is *On Intelligence: How a New Understanding of the Brain Will Lead to the Creation of Truly Intelligent Machines*, written with *New York Times* science writer Sandra Blakeslee. The book is a manifesto for a theory based on an elegantly simple premise: that intelligence is rooted in the brain’s ability to access memories rather than in its ability to process new data.

Hawkins is sure to ruffle feathers in the neuroscience and artificial-intelligence fields, given that he dismisses years of research in both camps. But he says he welcomes debate—and recognizes that he could well end up being proved wrong. Even if debunked, the book serves a valuable purpose by encouraging new ways of thinking about intelligence and efforts to build intelligent computers.

Hawkins complains that thinking machines do not exist because scientists have been sidetracked. Too many subscribe to the widespread view that the brain is essentially a powerful computer, constantly processing and integrating incoming data. Many computer experts believe that thinking machines will arrive once there are processors as powerful



Accessing memories, says the author, is the key to intelligence

and as integrated as human neurons. There is a problem with this brain-as-computer analogy, however: Computers are already faster than brains. A neuron can manage 200 operations per second; a modern computer can race through 1 billion per second.

Processing speed doesn’t matter in the brain, says Hawkins, because the basis of thought is not data manipulation but memory retention and prediction. The brain, he says, accesses previous experiences, compares them with existing circumstances, and predicts what is most likely to happen next. When a ball is thrown, for example, we know from experience where it is most likely to land and move our hands to that spot. It’s a simple action, but it has proved

nearly impossible to build a robot smart enough to perform it. “The brain doesn’t compute the answers to problems,” he says. “It retrieves the answer from memory.” Intelligence, posits Hawkins, is essentially the capacity to remember and then predict patterns in the world.

This so-called prediction model of intelligence has been hinted at by neuroscientists, and Hawkins includes a bibliography crediting his predecessors. But, he insists, these disparate bits and pieces have never been placed into a coherent theory. “This,” he says sweepingly, “is the goal of this book.”

Hawkins’ confidence does not spring

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Proactive

Intelligence explaining, in highly readable fashion, how the brain works. And unlike many much drier books on the subject, the author leavens the neuroscience with his own quirky professional history. Sometimes it's too quirky—the book has a certain breezy, Hawkins-centric style that can be off-putting. But he seems quite serious in his goal of inspiring others to try some new thinking about intelligence. So serious, in fact, that two years ago he founded the Redwood Neuroscience Institute to promote research on memory and cognition. Perhaps a clue to his next company? ■

—By Catherine Arnst

Hawkins spends much of *On*

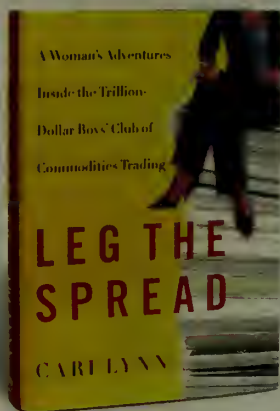
highs, the near-debilitating lows, and most of all, the jolt from the constant newness—and from the occasional win.”

For Lynn, a lot of the thrill comes from the odd characters, particularly women, who cope in different ways with the *Animal House* high jinks and the high risks. A pot-smoking University of Chicago grad makes \$20,000 a day for a while but fears that she might lose her newfound fortune. She burns out, passing out 20 minutes after the opening bell on her last day. She's now a filmmaker.

A 23-year-old financial trader in “sultry, skintight pants, and skimpy top” sports inch-long manicured fingernails and responds to a male clerk's remarks by punching him “full-out in the face.” And a eurodollar trader has “the guts of a man and the brains of a woman.” She has such big contracts that she is known as the “\$100 Billion Woman.”

Sound a bit hyped up? Well, *Leg* suffers from a bad case of breathlessness. Too many pits denizens are “legendary”—there's requisite “genius”—and the market almost always is “crazy.” Had the author used her delete button on the superlatives once in a while, her book might be better. Lynn, who has written for *Good Housekeeping* and *Health*, also gives scant attention to truly vital changes, especially the growth of electronic trading and the global explosion of interest in futures. At its best, *Leg* is an entertaining primer on a world that may go the way of the dinosaurs—but it could have been much more. ■

—By Joseph Weber



from recent dabbling. His interest in neuroscience was first sparked in 1979, a few months after he graduated from Cornell University with a degree in electrical engineering. The September issue of *Scientific American* that year was devoted to the brain and included a highly influential article by Francis Crick, co-discoverer of the structure of DNA. Crick wrote that the study of the brain “is conspicuously lacking a broad framework of ideas,” words that inspired Hawkins. “My lifelong desire to understand brains and build intelligent machines was brought to life.”

In Brief

This Is the Pits

LEG THE SPREAD

A Woman's Adventures Inside the Trillion-Dollar Boys' Club of Commodities Trading

By Cari Lynn; Broadway Books; 310pp; \$24.95

Computers are fast making relics out of Chicago's raucous and colorful futures pits. If they someday disappear, many Chicagoans may mourn. But Cari Lynn, author of *Leg the Spread: A Woman's Adventures Inside the Trillion-Dollar Boys' Club of Commodities Trading*, likely won't be one of them. Vulgar, juvenile, and sexist are tame terms for the locker-room milieu she found on the floor of the Chicago Mercantile Exchange from 2000 to 2002. Her book's title refers to a risk-minimizing play on futures, but coarsely hints at women's choices in the trading community.

Much of that world, Lynn writes, left her feeling queasy. It was as if the trading floor were “rigged with volts of negative energy, frustration, and agony that zipped across the room like an electrical storm.” But she couldn't deny that it had a certain appeal, chiefly because uninhibited greed brings out the basest instincts in people, guaranteeing excitement. Trading, shehapsodizes, is like romance: “the chase, the rush, the infatuation, the incredible

The BusinessWeek Best-Seller List

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2	SHUT UP, STOP WHINING, AND GET A LIFE Larry Winget (Wiley • \$24.95) <i>Tough love from a personal-development guru.</i>	—	1		2	SMART COUPLES FINISH RICH David Bach (Broadway • \$14.95) <i>Managing your money after you've walked down the aisle.</i>	1	12	
3	THE AUTOMATIC MILLIONAIRE David Bach (Broadway • \$19.95) <i>Putting your investment program on autopilot.</i>	1	9		3	WHAT COLOR IS YOUR PARACHUTE? Richard Nelson Bolles (Ten Speed • \$17.95) <i>The 2004 edition of the enduring job-search bible.</i>	3	11	
4	THE LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Bard Press • \$19.95) <i>A syndicated columnist on why people buy stuff.</i>	—	1		4	THE ABCS OF REAL ESTATE INVESTING Ken McElroy (Warner Business • \$16.95) <i>Stories from the real estate frontlines.</i>	—	1	
5	CONFIDENCE Rosabeth Moss Kanter (Crown Business • \$27.50) <i>Rising to the occasion, by a Harvard B-school professor.</i>	—	1		5	GETTING THINGS DONE David Allen (Penguin • \$14) <i>Organizing your office and managing your time.</i>	5	7	
6	PAY IT DOWN! Jean Chatzky (Portfolio • \$19.95) <i>The Today Show's financial editor on dumping your debts.</i>	—	1		6	SMART WOMEN FINISH RICH David Bach (Broadway • \$14.95) <i>Spending wisely and preparing for the future.</i>	4	10	
7	THE ART OF THE START Guy Kawasaki (Portfolio • \$26.95) <i>Positioning, pitching, and planning your startup, by a venture capitalist.</i>	—	1		7	EFFECTIVE PHRASES FOR PERFORMANCE APPRAISALS James E. Neal Jr. (Neal Publications • \$10.95) <i>How about "attaboy"?</i>	10	17	
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ETF STRATEGIES FOR LONG-TERM INVESTORS

The world's most heavily traded stock isn't that of an American software giant, a Japanese mega-bank or a European cell phone company. In fact, it's not the stock of one particular company. It's an exchange-traded fund, or ETF. The Nasdaq 100 Index Trading Stock, better known by its symbol, QQQ, trades nearly 100 million shares per day—half again as many as Intel or Microsoft.

Much of that volume comes from professional traders, but the QQQs also attract plenty of buy-and-hold investors. John Jacobs, who helped create the QQQs for Nasdaq and is now creating locally denominated versions of the shares for stock exchanges around the world, figures that about 800,000 to 900,000 of the portfolio's million shareholders (a breadth of ownership matched by only a few dozen companies) are long-term investors. He expects those numbers to climb as ETFs are increasingly offered in 401K retirement plans, an area that has up until now been largely the domain of mutual funds.

But hold on: can the QQQs truly be called the most heavily traded *stock*, or are they more of a mutual fund? We'll leave that judgment up to you. But ETFs have become wildly popular in recent years with traders and long-term investors alike largely because they have attributes of funds *and* stocks.

Like index mutual funds, ETFs represent baskets of stocks. The stocks may be components of a particular index: the QQQs, Standard & Poor's Depository Receipts (symbol: SPY, commonly called "spiders") and Dow Industrials Diamonds (symbol: DIA) are designed to mimic the performance of the Nasdaq-100, S&P 500 and Dow Jones Industrials indexes. There are also ETFs for particular market capitalizations and sectors, such as the Mid-Cap Vipers (VO) and Health

Care Vipers (VHT), both offered by Vanguard. And there are ETFs for specific countries and regions, for different investment styles such as growth and value and for bond indexes, whether corporate or government, taxable or non-taxable.

Like index funds, ETFs boast ultra-low internal fees and tax efficiency. The Spiders, for example, have an expense ratio (the percentage of assets that goes toward fund expenses) of 0.10%, less than any large-cap index fund available to retail investors. They also haven't paid a capital gains distribution since 1996. The QQQs have an expense ratio of 0.20%, and have never paid a distribution.

The similarities between ETFs and index funds, though, stop there. Whereas most mutual fund shares are priced once daily after the stock market's close, meaning that orders placed during the day are held until that time, ETF shares trade constantly throughout the day, just like stocks. That makes them popular among day-traders.

"Investors like the flexibility," says Cliff Weber, Senior Vice President of the American Stock Exchange's ETF Marketplace, where more than 80% of ETFs trade. "With ETFs they can specify limit prices and enter stop orders, just like with stocks." Weber notes that ETFs have corresponding option contracts, which allow investors to customize their risk-reward profile.

The Sector Shift

Most asset allocation plans call for investor's funds to be spread between stocks and bonds, with a certain portion of the stock funds invested in slow-and-steady companies, like banks, and a smaller portion put in high-growth, high-risk holdings, like technology companies. Over time the fastest-growing parts of the portfolio must be pared back, and the proceeds distributed to the slower ones.



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ETFs offer a convenient way for investors who don't want to pick individual stocks to allocate their funds across different sectors. And they make it just as easy to shift money by selling shares of a technology ETF and using the proceeds to buy a different sector.

Get Smaller

Just as it's important for investors to diversify their holding among different sectors, it's important to spread money between companies of different sizes. Many investors' portfolios are overweighted in large, familiar companies like Microsoft and General Electric, both of which have market capitalizations in excess of \$250 billion.

But small-cap companies, those with market capitalizations of less than \$1 billion, typically have earnings growth rates that are much higher than those of large-cap stocks. Midcaps, which have market caps between \$1 billion and \$5 billion, provide a nice blend of the fast growth associated with smaller companies and the financial stability displayed by larger ones. Midcap and small-cap ETFs make it

want to risk his principal. He buys a zero-coupon treasury with a 10-year maturity value of \$100,000, which at the moment sells for about \$65,000. That leaves \$35,000 left over for ETFs. Provided that Smith holds the zero until maturity, he's guaranteed to receive his original \$100,000 whatever the ETF shares are worth.

Keep Your Options Open

ETFs, unlike mutual funds, offer experienced investors the ability to use options strategies to protect their principle, or try to enhance their returns. For example, suppose an investor, Ms. Vanderbilt, feels that at \$35 apiece, her 1000 shares of the QQQs have temporarily peaked, and wants to sell them in November, but also would like to defer generating a taxable gain until next year. She could purchase put options betting that the share price will fall. A bet toward the end of the year that her 1000 shares of the QQQs will fall below \$35 per share before Jan 2005 might cost \$1000 or \$2000. If the QQQs stay above \$35 per share, she loses the cost of the option.

"With ETFs they can specify limit prices and enter stop orders, just like with stocks."

Cliff Weber, Senior Vice President of the American Stock Exchange's ETF Marketplace
Visit <http://www.nasdaq.com/qqq>

easy for investors to reduce over-exposure to big companies by investing in broad baskets of smaller ones.

Portfolio Protection

Treasury bonds are ideal for using with ETFs to protect principle in a strategy called a zero wrap. The strategy uses a particular type of Treasury called a zero-coupon, which doesn't pay interest, but rather is bought at a discount to its maturity value—not unlike the Series EE government savings bonds sold by banks. Like all Treasury bonds, "zeros" are backed by the faith and credit (and unlimited taxing authority) of the United States government.

Suppose Mr. Smith puts part of his \$100,000 portfolio in ETFs, but doesn't

If they fall below \$35, Vanderbilt's gain on the options make up for her loss on the stock.

Options carry a high degree of risk making them appropriate only for the most experienced investors.

With so many different types of ETFs available, and so many strategies for using them Weber sees tremendous potential for broader ETF appeal. Says Weber: "The more investors learn about all the different ways they can use ETFs, the more popular ETFs become." ■

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BY STEPHEN H. WILDSTROM

This Shrunk PC Takes Tiny Too Far

Model 01 from OQO in San Francisco is a technological marvel. The device which OQO (oh-cue-oh) calls an “ultra personal computer,” is a full-fledged Windows XP computer, complete with display and keyboard, in a 14-oz. package small enough to slip into a pocket. The big question once you get past your first impression is just how you would use it.

You might think such a shrunk PC could have broad appeal, given the deficiencies of current handhelds. Microsoft Pocket PCs, such as the Hewlett-Packard iPAQs, are the most capable standard handhelds around, but they still fall far short of the full Windows experience. For example, they can run only software written for the Pocket PC; their e-mail, calendar, and contact programs are underpowered compared with Outlook; the Pocket Word and Pocket Excel programs mangle any documents that were originally formatted on the desktop; and there's no version of PowerPoint.

Shrinking the whole Windows PC down in size, on the other hand, doesn't seem to be a good alternative. OQO has cleverly crammed Windows into a 5-in.-by-3½-in. box just under an inch thick, with the display nearly filling the top. The text is a bit hard to read for those of us with aging eyes, but the 800-pixel-wide screen can display a standard Web page without horizontal scrolling. The display slides forward to reveal a keyboard, which is designed to be worked with two thumbs like the smaller keyboards on the BlackBerry and Treo (page 118). A pointing stick on the left moves the cursor, and two buttons on the same side simulate the left and right mouse buttons. You can also control the display with an electronic stylus, similar to those used in Tablet PCs. Like other thumb keyboards, the OQO's is adequate if not great, but I found the small size of screen objects made it tricky to position the cursor precisely with either the pointing stick or the stylus.

THE BOTTOM LINE IS THAT SIZE MATTERS, and smaller is not always better. Windows XP was designed for a display measuring at least 10 in. diagonally—a screen nearly six times the area of the OQO's. It turns out Microsoft has a good reason not to cram the full functionality of Outlook into a Pocket PC: It is hard to use Outlook's multipane layout on a screen that small—and the same goes for most other applications not specifically designed for small displays.

The computer's tiny screen also means there is little room



for external connections. One USB port and one FireWire port plus Bluetooth short-range wireless are it. For any other connections, including an external monitor or a wired network, you use a stiff, four-foot “docking cable” that has various connectors strung along its length. A more conventional docking cradle would have been nice.

Even battery life was disappointing. The small screen requires less juice, but the battery is smaller. So in power need

The OQO's screen is hard to read, and its keys hard to hit

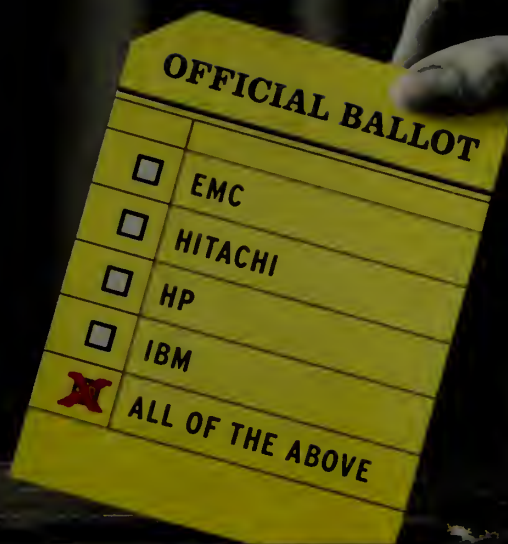
the OQO is not much different from a laptop. Despite an ultra-low-power Transmeta Crusoe processor, the OQO runs barely two hours on a charge, requiring a couple of \$99 spares. The bill materials is also much like that of a normal laptop, with a premium for miniaturization. The result is a price starting at \$1,899, with a 20-gigabyte hard drive and 256 megabytes of memory.

I think the combination of technical shortcomings and high price will limit the OQO's appeal to those who really need to run regular Windows programs on a tiny device. And even for that group, the OQO isn't the only alternative. Antelope Technologies puts the guts of a PC into a Modular Computing Core a bit smaller than the OQO that can be plugged into a variety of display configurations. And Microsoft co-founder Paul Allen's Vulcan is developing the FlipStart, which is just a bit larger than the OQO, with a more conventional clamshell design. Maybe they all see something I don't, but these tiny PCs smack of technology for its own sake. They may not serve a true market need. ■

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BY ROBERT J. BARRO

Debunking the Myths Of the Kerry Campaign

The Bush Administration's economic policies are a mixed bag of sound tax and monetary policies offset by poor spending discipline and inconsistency on free trade. But there's nothing mixed about John Kerry's campaign criticisms: They're politically motivated economic myths. Myth No. 1 is that the new jobs being created are low-quality. Low-paying hamburger flippers

are said to be replacing high-wage auto workers. We can check this claim by looking at real wage rates. Data from the Bureau of Labor Statistics show that the growth rate of average hourly earnings of production workers in the total private economy from January, 2001, to September, 2004, was 2.7% per year. To adjust for inflation, we subtract 1.9% per year for changes in the price deflator for personal consumer expenditures. Thus, real hourly earnings grew by 0.8% per year. Finally, we should adjust for fringe benefits. Because benefits rose faster than earnings, total real labor compensation per hour rose by 1.3% per year.

HOW DOES THIS COMPARE with earlier times? The calculation for 1991 to 2000 shows that total real labor compensation per hour rose by 1.1% per year. For the 1980s, data on fringe benefits are less accurate. As an approximation, total real labor compensation per hour was virtually unchanged. Thus, 2001-04 had faster growth of real labor compensation than the 1990s or 1980s. Under Bush, the economy seems to be creating "good jobs with good wages."

Myth No. 2 is that the income-tax cuts of 2003 were a failure. In the period since the enactment of the tax law in May, 2003, real gross domestic product grew by 4.7% per year, real business investment expanded by 15.5% per year, labor productivity rose by 3.8% per year, and the unemployment rate fell from 6.3% in June, 2003, to 5.4% today. I cannot prove that the tax plan caused the strong economic performance, but the plan clearly enhanced incentives to work, produce, and invest. The marginal-income-tax rate cuts in the 2001 law were accelerated to 2003, tax rates on dividends and capital gains were reduced, and some depreciation allowances were liberalized.

Myth No. 3 is that the recent decline in the unemployment rate by nearly a full percentage point somehow does not count. The unemployment rate comes from the BLS' Household Survey, which also reports levels of employment and the labor force. These two variables are unreliable on a month-to-month basis. Nevertheless, the ratio of employment to the labor force, which determines the unemployment rate, provides a useful month-to-month gauge of the labor market. Despite revisions, the unemployment rate is a consistent indicator of the business

cycle. When it fell from 6.3% in June, 2003, to 5.4%, it meant that typical job seekers had an easier time finding work.

Kerry supporters argue that, because of measurement error in household employment, we should ignore the relatively favorable movements in this indicator since January, 2001. Household employment rose by 1.7 million up to September, 2004, while payroll employment fell by 800,000. Kerry exaggerates the decline in payroll employment by focusing on the drop, by 1.6 million, in private-sector jobs. Does he really not want to count the new jobs for public school teachers, police officers, and mail carriers?

The Kerry people also argue that we should rely on changes in the reported labor force to discount the decline in the unemployment rate. But the labor force statistics have the same measurement problems as household employment. It is true that after rising sharply from the 1960s to the 1990s, mostly because of the increased participation of women, the participation rate seems to have leveled off. However, there is no evidence that anything special is going on with respect to discouraged workers.

Myth No. 4 is that Democrats do better than Republicans at managing the economy. The supporting evidence is that President Bill Clinton's two-term economic record was better than that of Bush I or Bush II. Yet considering inflation, unemployment, and growth, Reagan had better results than Clinton. And Carter had the worst economic performance of all 14 Presidential terms since 1949. For the entire post-World War II period, average economic results under Democrats have been similar to those under Republicans. I'm trying to be balanced here, but the Kerry economic myths are just myths. ■

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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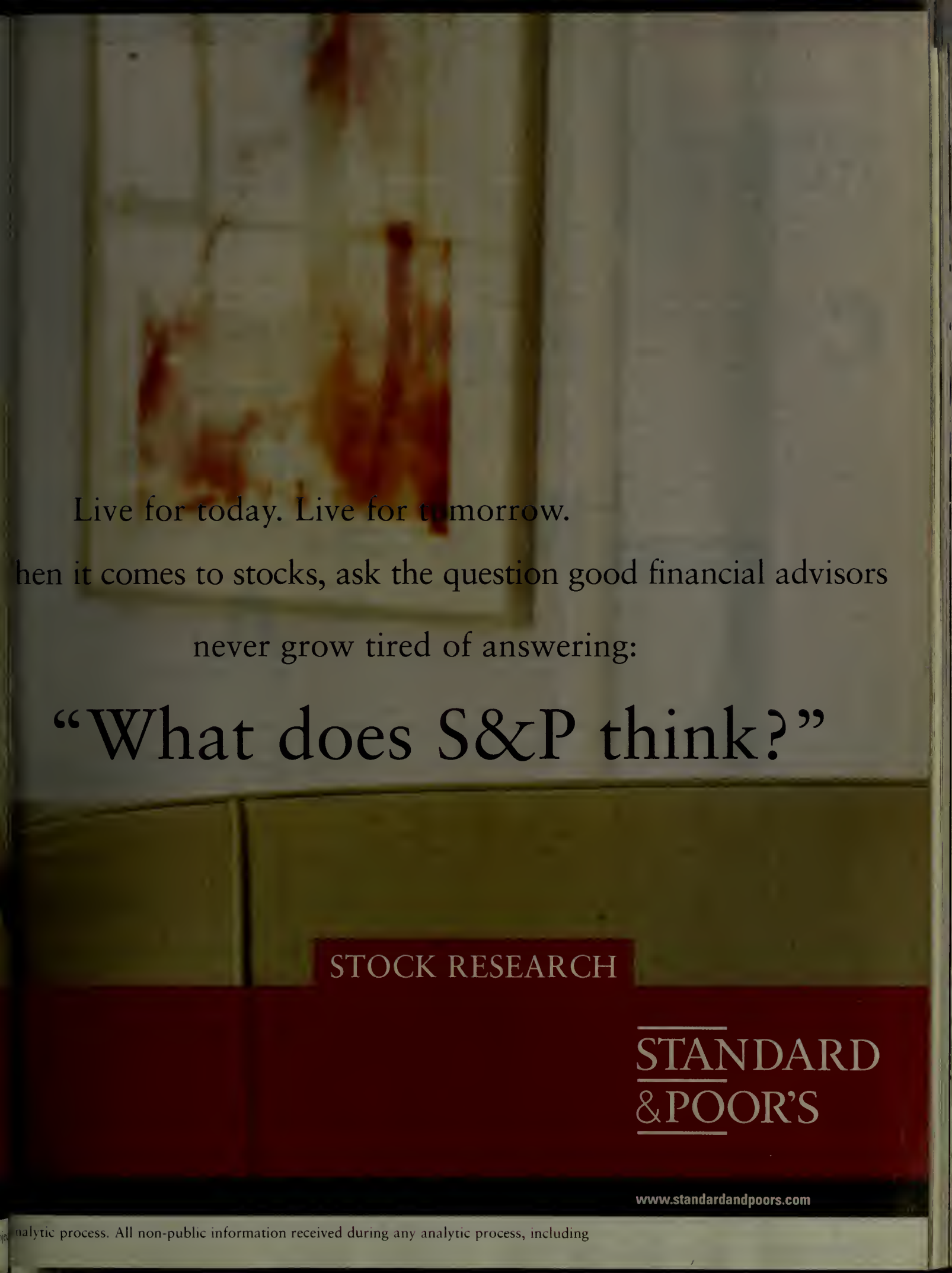


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BY JAMES MEHRING

AFTERGLOW OF A TAX HOLIDAY

Repatriated profits could boost the U.S. economy

CORPORATE AMERICA'S LATEST tax break could provide a timely boost to the economy. On Oct. 11, Congress passed the American Jobs Creation Act of 2004. The law includes a provision to temporarily cut the tax rate on profits earned abroad and brought back home. According to economists Bruce Kasman and Robert Mellman at J.P. Morgan Chase & Co., the repatriation of these profits could add a half percentage point to real gross domestic product next year.

The tax holiday, which will be in force until September, 2006, at the latest, is meant to address a quirk in the U.S. tax code. When a U.S. company operates overseas, the profits earned are subject to local tax laws. If brought back home, the repatriated earnings are taxed at a 35% rate by the U.S. government, with companies getting a credit for taxes already paid abroad. If the local tax rate is less than 35%, American companies are better off keeping the profits abroad.

Under the new law, any profits booked prior to 2003 but still parked overseas could be repatriated in 2005 and subjected to a reduced 5.25% tax rate (chart). But there is a catch. Companies must have a board-approved plan to use the money on such projects as research and development, hiring, paying off debt, and capital investment.

A survey conducted by J.P. Morgan Chase soon after the tax holiday idea was first hatched in early 2003 showed over 50% of respondents said they would repatriate nearly all their foreign profits if the plan were enacted. The bank expects that nearly \$300 billion of a potential \$500 billion in eligible earnings will be repatriated in 2005.

RAKING IN THE CASH OVERSEAS



Once they return to the U.S., the funds could be used to create 200,000 jobs next year, say Kasman and Mellman, although other economists think the total could be considerably smaller. Even so, with high oil prices and a flagging global economy slowing the U.S. recovery, the tax break should provide some oomph.

R&D: HOW BIG A BOOST?

It's not the productivity engine you might think

RESearch AND DEVELOPMENT has been credited as a key source of productivity growth in the postwar era. But a paper by New York University assistant economics professor Diego Comin to be published in the upcoming issue of the *Journal of Economic Growth* casts some doubt on the extent of R&D's power to enhance productivity.

Economists in the past have measured the correlation between productivity and R&D, defined by the National Science Foundation as research performed by people in the physical sciences. Those studies typically showed that R&D has accounted for 70% or more of the growth in productivity. But Comin noticed that past work overstated R&D's effect on productivity because researchers could not separate the gains coming from reengineering, such as a streamlined assembly process or a new inventory management system, from those generated by R&D alone.

To correct this error, Comin looked at postwar figures on R&D spending from the NSF, along with data on real GDP, productivity growth, and inflation-adjusted stock market returns. He narrowed his study to work that yielded a new product or capital good, since he says "the effect of R&D on productivity is embodied in these new goods."

He then adopted a two-step approach to measure R&D's effects on productivity growth. First, he determined what effect increased research outlays had on the growth rate of new technologies. To help simplify the process, Comin assumed that there were no barriers to

undertaking R&D. Second, he computed how the growth rate of R&D-created technologies affected productivity. As research spending rose, the level of productivity also increased.

Comin's study estimated that R&D accounts for 10% to 20% of productivity's 2.3% annual growth rate since 1950. While that's much smaller than previous calculations, his number still represents a significant contribution in an era when companies are obsessive about cutting costs and improving efficiency.

POWERED BY PRICES

Execs see margins rising as price hikes hold

AS THE YEAR COMES TO A close, executives and economists are feeling less optimistic about the U.S. economy. But the

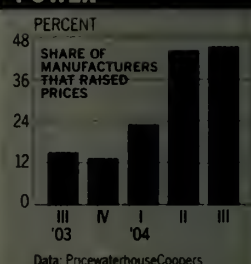
Manufacturing Barometer from PricewaterhouseCoopers, a survey of management at 75 multinational manufacturers, found that respondents still see better days ahead for their own companies.

Although the respondents' optimism regarding economic growth in the U.S. and abroad is starting to wane, they expected, on average,

that their own companies' revenues will grow by 9% in the next 12 months, up from a forecast of 4.4% as year ago.

The main reason is a revival in pricing power. The PWC survey showed that 45% of respondents said they increased prices in the third quarter, triple the 15% level from the previous year (chart). The ability to boost prices is helping to lift margins despite rising costs. Nearly 50% of those surveyed said their gross margins had improved over the past three months. ■

MORE PRICING POWER



A hand is shown pulling a chain to turn on a lantern light. The lantern is made of metal and has a glass globe inside. The background is a warm, yellowish-brown color.

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BY JAMES C. COOPER & KATHLEEN MADIGAN

How Costly Oil Will Test the Economy

Consumer buying power will suffer, but the Fed has room to keep rates low

U.S. ECONOMY This economic recovery just can't seem to catch a break. It has been hit by one shock after another: the terrorist attacks in 2001, the corporate scandals in 2002, and war in Iraq in 2003. Now, it's the 2004 oil shock. Somewhat amazingly, the economy has managed to grow 3.5% annually since the recession ended in late-

2001, and 4% during the past year. Clearly, that performance is a testament to the economy's resilience, especially since job growth has lagged so far behind the typical recovery experience.

But this year's oil shock is different. This isn't just a blow to the psyches of consumers, businesses, and investors. It's a direct hit to the pocketbooks of millions of U.S. households and companies. It results in a sizable chunk of national income getting transferred overseas, which then generates secondary impacts on demand, production, and prices.

Federal Reserve officials estimate that the buffeting from costlier oil has already knocked up to three-fourths of a percentage point from growth through the first three quarters of 2004. But now, after averaging \$35 per barrel in the first quarter, \$38 in the second, and \$44 in the third, oil is hovering in the range of \$50 to \$55 per barrel.

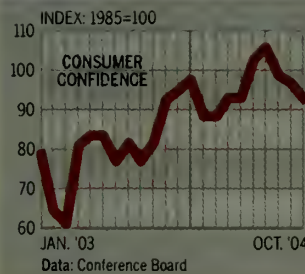
The key to the outlook is where the price will go from here, and not even the sharpest oil analyst knows the answer. That uncertainty is another threat to growth, to the extent that fear of the unknown causes economic players, especially businesses and investors, to hesitate in their buying decisions.

SO FAR, THE ECONOMY'S RESILIENCE continues to shine through, as it has done throughout this recovery. Reaction to the oil shock remains mixed. Through early October, the prospect of costlier energy is dampening consumer confidence, but business surveys remain relatively upbeat. Investors are wary about oil's potential impact on future profits, yet policymakers at the Federal Reserve are not offering the slightest hint that they are concerned about any sudden weakening in the economy.

As with any shock, the economy's reaction will have to be gauged from economic report to economic report. The problem right now is that the upcoming October data may not offer much guidance. The latest surge in crude prices has come quickly—some \$12 per barrel in only two months—and the full impact on overall demand is yet to come. Plus, several key indicators, such as payroll jobs and industrial production, are likely to post good gains for October, partly reflecting a bounceback from hurricane-depressed results in September.

Indeed, the Labor Dept.'s state-by-state tally of employment, reported on Oct. 22, strongly suggests that hurricane-related effects in several Southern states hurt September payrolls. In a sampling of states hit hard by wind and flooding, including Florida, Alabama, Louisiana, and North Carolina, employment in each fell substantially from August, even though job growth during the previous three months had increased in each state. Other states in which the Federal Emergency Management Agency had designated disaster areas showed a similar pattern.

OPTIMISM FALLS FROM ITS JULY PEAK



during the previous three months had increased in each state. Other states in which the Federal Emergency Management Agency had designated disaster areas showed a similar pattern.

All totaled, economists generally agree that Labor's report of a 96,000 increase in September payrolls undercounted job growth

by some 50,000 workers. That suggests October payrolls will be up by more than they would have been otherwise.

Any lagging effects of \$50-\$55 oil are not likely to show up until the November reports at the earliest, which won't be out until December. Sales of both new and existing homes posted surprising gains in September, up 3.5% and 3.1%, respectively. And consumer spending, outside of autos, appears to be holding up in October. Wal-Mart Stores Inc. has affirmed its expectation that sales in the month will rise in the 2% to 4% range, better than the September showing. But, as in the second quarter, when growth in consumer spending slowed to a paltry 1.6% pace, households are bound to suffer a loss of buying power in coming months as the price indexes jump.

WHAT'S CLEAR RIGHT NOW is that consumers are losing faith in their prospects. In addition to costlier energy, other worries about jobs, increasing violence in Iraq, a weak stock market, and a divisive election are weighing on household attitudes. Consumer confidence in October fell for the third month, according to the Conference Board's gauge (chart). The index dipped

almost four points, to 92.8, dragged down primarily by a weaker assessment of future conditions. Households' assessment of present conditions dropped only slightly.

Interestingly, consumers said they were a tad more upbeat about current employment conditions. More households characterized jobs as "plentiful" than in September, and fewer said jobs were "hard to get." That response supports the notion that September job growth was depressed by severe weather.

Meanwhile, most surveys show that Corporate America is still upbeat. In particular, new orders for capital goods, excluding aircraft, rose 2.6% in September, the strongest showing in six months. Orders for computers and related products posted an especially strong 9.3% advance, the largest gain in more than four years. Bookings for new equipment are a good indicator of business confidence, since they represent hard financial commitments to future activity, and through September they remain in a clear upward trend (chart).

GAUGING THE DEPTH of the oil shock on consumers and businesses will be uppermost in the minds of Fed officials in coming months. Rising oil prices will not deter another quarter-point hike in the Fed's target interest rate to 2% at its Nov. 10 meeting. The question is, will the policymakers take a break at its Dec. 14 meeting from this year's steady pace of tightening?

In a recent speech, Fed Governor Ben S. Bernanke made it clear that policy "will not be closely linked to the behavior of oil prices per se" but on how the data on

inflation and growth play out. That strategy may well give the Fed room to hike again in December.

What is different this time, compared with past oil shocks, is that the Fed has an unusual amount of flexibility. For one thing, even if the target rate rises to 2.25%, the rate is still only slightly above inflation, as

measured by the Fed's preferred indicator. That means policy is still accommodative to growth at a time when the economy may need that support.

Therefore, it would likely take a considerable weakening in the economy to cause the Fed to halt its tightening cycle. And even then, already low interest rates

would pose less of a problem for inflation than in the past. Unlike past oil shocks, higher oil prices do not appear to be raising expectations of higher inflation. As Bernanke suggested, the Fed may even have the leeway to lower rates, if necessary.

To be sure, how the economy comes through the winter months will provide the ultimate test of this so far Teflon recovery. Nothing has stuck to it long enough to do any permanent damage. So until spring, keep a close eye on the data—and your fingers crossed. ■

EQUIPMENT ORDERS ARE STILL RISING



BRAZIL

Stepping Harder on the Brakes

THE CENTRAL BANK of Brazil surprised investors by hiking interest rates more than expected. The aggressive move is designed to slow the economy before inflation worsens.

On Oct. 20, the central bank lifted its target base rate by a half percentage point, to 16.75%. Analysts had projected only a quarter-point hike, similar to the increase made in September. The economy has been beating forecasts, while also boosting the popularity of President Luiz Inácio "Lula" da Silva. In the second quarter, real gross domestic product was up 5.7% from previous-year levels, even though forecasts at the start of 2004 said Brazil would grow only about 3% to 3.5%.

The momentum carried into the third quarter. Industrial production in August rose for the fifth month in a row. It now stands 13.1% above previous-year levels. Exports last quarter hit a record, thanks in part to a surge in auto shipments. Plus, the jump in production is pushing businesses to hire. Brazil's jobless rate fell to 10.9% in September, the lowest reading since the end of 2003.

Strong demand has caused consumer prices to rise at a rate above the bank's inflation target of 5.1%, which already had been revised up. And given the continued gains in fuel prices, the bank is worried inflation will increase even faster for the rest of this year and 2005. That's

why hikes at the last two policy meetings of 2004 look certain.

Critics, however, warn that the central bank may move too fast and short-circuit the recovery. Some reasons for the inflation pickup are production bottlenecks and shortages. But if companies face higher borrowing costs, they'll be less likely to invest to expand capacity. In addition, higher rates will worsen the public debt situation and draw money away from private investment. Servicing the debt already takes up about 9% of the federal budget.

What's worse, Brazil needs growth of at least 5% to create enough jobs to keep the unemployment rate from rising. The promise of such prosperity is why Brazilians elected Lula. But the central bank seems to be signaling that given a choice between job growth and curbing rapid price gains, it's ready to give up some hiring to fight inflation. ■

ANOTHER SIGN OF A HOT ECONOMY





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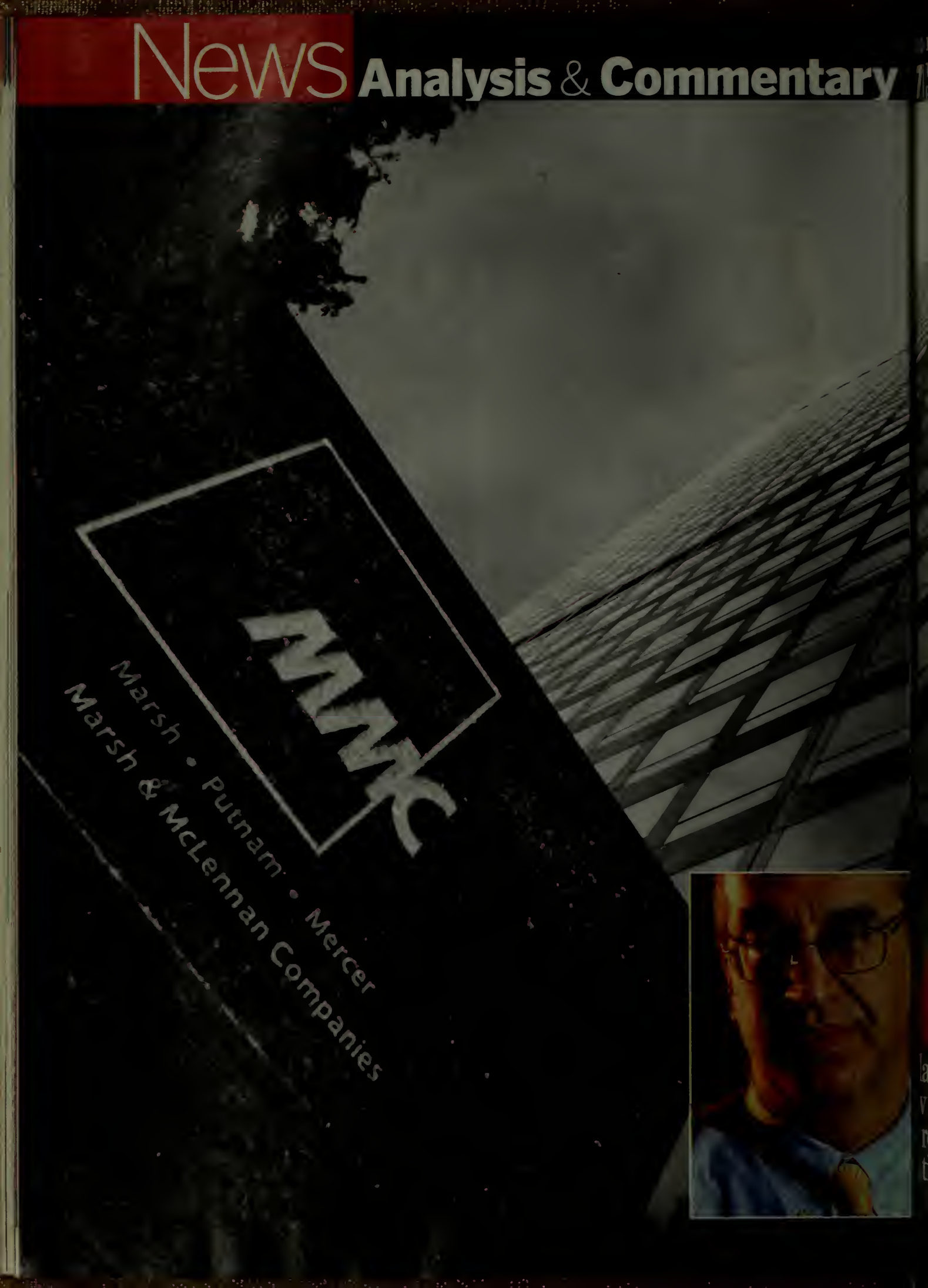
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INSURANCE

CAN HE REINVENT MARSH?

Mike Cherkasky, Marsh & McLennan's new broom, must clean up the culture—and find a fresh business model

IN JULY, WHEN THE WORLD'S biggest insurance broker, Marsh & McLennan Cos., bought Kroll Inc., the investigations and crisis management company, it had no idea how smart the purchase would turn out to be. Kroll is the only Marsh Mac division not tainted by scandal. First, Marsh Mac tapped Michael G. Cherkasky, the head of Kroll, to run its insurance-broker division. Then, on Oct. 26, the board made him head of the entire \$12 billion financial-services behemoth.

Cherkasky, a former prosecutor, seems to be the right man at the right time. He has already avoided the worst outcome: the possibility of a criminal indictment of Marsh Mac that could have put it out of business. But Cherkasky, 54, still faces a mammoth challenge in restoring the firm's reputation and shoring up its finances. Although the firm is likely to sur-

vive, analysts say it could end up a shadow of its former self. Already, investors have wiped out nearly 40%, or about \$9 billion, of its market cap since New York Attorney General Eliot Spitzer sprung his trap on Oct. 14 with a civil suit that charges Marsh Mac with rigging bids and accepting payments for directing clients' business to selected insurers. All the major credit-ratings agencies subsequently downgraded its debt, sharply hiking the cost of borrowing the money the firm needs to finance its brokering business.

Marsh Mac may bear the brunt of the insurance scandal, but the entire insurance industry is coming under greater scrutiny from regulators and law enforcers (page 44). Spitzer is also investigating other brokers and insurers, including Aon, ACE, and Willis Group Holdings. Meanwhile, American International Group Inc., one of the world's biggest insurers, is facing a Justice Dept. investigation into its sale of a prod-

We haven't determined, dollar for dollar, how we'll replace the revenue [from contingency fees]"

—Michael Cherkasky
CEO, Marsh & McLennan Cos.

PHOTOGRAPHS BY JENNIFER S. ALTMAN; (INSET) TODD FRANCE

uct that allegedly enabled cell-phone distributor Brightpoint Inc. to inflate its earnings. Regulators are also looking into deals in which AIG allegedly arranged for client PNC Financial Services Group Inc. to shift loans off its books.

A SERIOUS BLOW

EXPERTS SAY THE insurance industry will be forced to change the way it does business. With many fees under fire and rigged bids taboo, insurers and brokers are likely to suffer a serious financial blow. Says Morgan Stanley insurance analyst Vinay Saqi: "[They have] had a difficult time making money when the game is rigged in their favor. We're concerned they won't fare well in a truly competitive environment." Worse yet, the scandals might prompt some major clients to side-step brokers altogether and set up captive insurers either alone or in groups to handle most of their insurance needs.

Cherkasky was briefly Spitzer's boss in the New York County District Attorney's Office and the two are friends. Indeed Cherkasky has given \$14,500 to Spitzer's campaigns since 2002. Spitzer's office said he will not accept any further donations in the future.

Cherkasky moved fast to meet Spitzer's demands. He oversaw the ouster of CEO Jeffrey W. Greenberg and axed contingency fees—payments from insurance companies for steering business their way. He promised more transparency on fees and a beefed-up effort to ensure that Marsh Mac employees comply fully with laws and regulations.

Those moves may be enough to blast away Marsh Mac's notoriously secretive and allegedly corrupt culture (BW—Nov. 1). But once Cherkasky has stabilized the company he must focus on stanching its bleeding finances. Some \$845 million—half of the insurance broker's annual profits—came from contingency fees. That revenue has suddenly evaporated—and Cherkasky concedes he

hasn't worked out how to make it up. On a conference call on Oct. 26, he told reporters: "We haven't determined, dollar for dollar, how we'll replace the revenue." Yet the next day he told analysts that Marsh Mac will still pay a 34¢ quarterly dividend, at a cost of \$178 million—a hefty sum for a company whose profits are under siege. Cherkasky did say Marsh will still charge insurers for certain services it provides, without giving details. But Jay H. Gelb, a Prudential Equity Group LLC analyst, figures Marsh will be able to replace only a quarter of the lost fees by charging higher commissions. (About 20% of revenues come from commissions that aren't in dispute.) Still, Marsh will have to tread gently or risk losing clients to rivals.

Marsh's cash will also be depleted by any settlement money it has to fork over as well as the costs of other lawsuits. Experts say that bill may run as high as \$1 billion. Says Adam Klauber, research director at Chicago insurance researcher Cochran, Coronia & Co.: "If Marsh Mac can't pay for it out of

Settlement cash and the cost of lawsuits could reach \$1 billion

cash flow, it will need to stabilize its debt rating and eventually get it raised in order to increase financing options.

That could be tough. This summer, Marsh Mac shelled out \$1.9 billion in cash and debt to buy Kroll. Many analysts argued that it had overpaid. They say, Marsh Mac maxed out on the amount new debt banks are likely to let it take on. Says Ma-

Lane, an insurance analyst at William Blair & Co. in Chicago: "Marsh Mac will likely have to raise cash through hybrid equity issues like convertibles."

FIRE SALE?

IF MARSH MAC'S financial situation gets much worse, Cherkasky might have to consider selling its Putnam Investment mutual-fund division, along with pension consulting and human-resources arm Mercer Consulting Group, to raise cash. Lane estimates that Putnam is worth \$1 billion and Mercer \$3.5 billion. In a fire sale, he says, they would fetch far less. Marsh Mac would be hit with a substantial tax bill. Besides, Marsh Mac lenders would probably veto the idea: The firm is worth more as a whole.

Still, Marsh Mac might be tempted to spin off the divisions to satisfy shareholders simply to lessen the potential conflicts of interest that arise from selling the products to each other's customers. For example, Mercer is being investigated by regulators for various practices, including pushing Putnam funds to pension clients. Analysts say a spin-off might ease pressure from regulators, but it wouldn't add much to the broker's cash reserves.

Mercer and Putnam seem to be the least of Cherkasky's worries. Right now, Marsh Mac is facing a possible exodus of brokers. Willis and other brokers say they've been inundated with calls from Marsh employees. To stem the outflow, Marsh may have

Extreme Makeover

New Marsh Mac CEO Cherkasky has axed contingency fees and promised greater disclosure and improved compliance. But he still has plenty to do:

REPLACE LOST REVENUES

Half of Marsh's profits came from the nixed contingency fees. Cherkasky says Marsh will still charge for some services it provides insurers. But the company's ability to raise standard commissions is limited because clients could walk.

RETAIN MARSH'S BROKERS

Many of them are looking to leave, and with stock options underwater, the company may have to hike pay packages to prevent large-scale defections. That would further strain the company's financial resources.

RENEGOTIATE LOANS

Marsh will need to negotiate out a deal with banks to secure working capital. But now that the company's debt has been downgraded, obtaining much-needed financing will be trickier—and more expensive.

HANG ON TO CLIENTS

Some, especially midsize companies, are likely to jump to smaller brokers that don't have regulatory problems. Marsh hopes it will be able to stem defections by answering clients' questions and providing complete fee disclosure.

END CONFLICTS OF INTEREST

Cherkasky must eliminate problems arising from cross-selling among subsidiaries. Regulators are investigating Mercer for pushing Putnam mutual funds and Putnam for pushing Marsh-brokered insurance products.

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pay its brokers more to offset suddenly worthless stock options, putting more pressure on its bottom line. Clients could walk, too. Cherkasky shrugged off this threat during his Oct. 26 press conference, saying that by changing its business model and increasing transparency, Marsh will hold onto most of its clients.

The truth is, it's difficult for clients to jump ship to another broker. Even though Aon Corp. has its own Spitzer-related woes, Marsh and Aon, the two largest insurance brokers, are about the only firms that can handle major global risks, say analysts. Clients don't move around a lot. According to Cochran Cornia's Klauber, 93% stay with their broker. The reason: Voluminous and sensitive client information must be provided to bidders, and then the broker must analyze the bids. "It's a very complex process. It's difficult to snap your fingers and say: 'I want to get rid of Marsh,'" he says. In early September—the renewal deadline to have policies in place by Jan. 1—about 40% of clients had renewed their agreements with Marsh. But, analysts say, many corporate risk managers are mulling a change for 2006.

The industry as a whole isn't out of the woods, either. The big risk: Corporate clients will decide to put together their own insurance policies, axing brokers altogether. According to Morgan Stanley, a record number of captive insurers—subsidiaries that companies set up to handle their own insurance—were set up last year. Says Morgan Stanley's Saqi: "What risk manager, treasurer, or CFO wouldn't consider alternative sources of risk financing after having the bond of trust with its broker/insurer challenged?" Companies could also decide to bypass brokers and strike up deals with insurance companies directly.

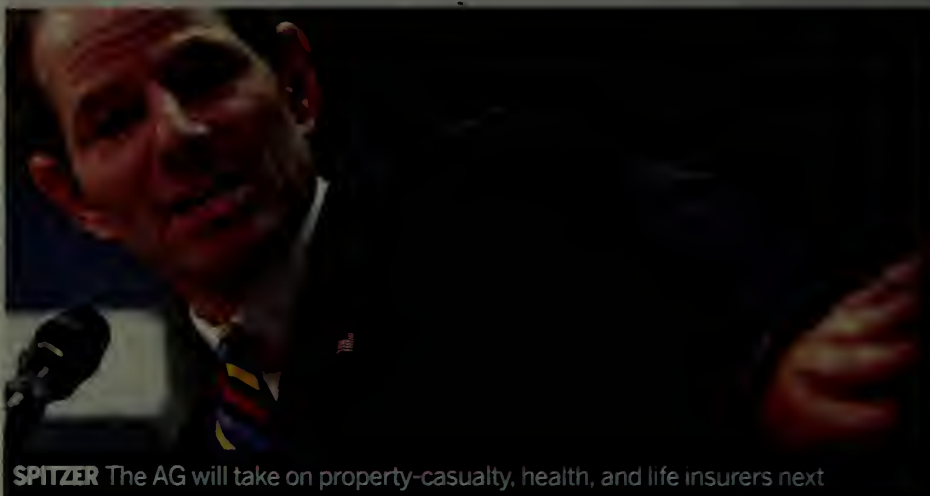
The industry could remain on probation for years as state regulators scrutinize them—and the rates they charge—with renewed vigor. The National Association of Insurance Commissioners has said it will try to break the market power of the big brokers. Meanwhile, other brokers and insurers are sure to be hit by lawsuits as Spitzer expands his probes.

Marsh Mac must get through its legal mess and hammer out a settlement that includes restitution to its clients. Sources close to Spitzer's investigation say it's unlikely this will happen as quickly as Marsh Mac would like. This is one crisis that will require all of Cherkasky's skills. ■

—By Marcia Vickers, with Diane Brady, in New York and Joseph Weber in Chicago

INVESTIGATIONS

Cracking the Insurance Biz Wide Open



SPITZER The AG will take on property-casualty, health, and life insurers next

Eliot Spitzer's run at insurance broker Marsh & McLennan Cos. looks increasingly as if it could be just the opening battle in a wide-ranging war against abuses in the insurance industry. The crusading New York Attorney General is expected to bring criminal fraud charges against at least three Marsh employees in the next several weeks for their alleged roles in bid-rigging on insurance contracts, sources close to the investigations say. Spitzer is also moving quickly to take on other brokers and will soon begin probing insurers directly, including property-casualty, health, and life insurers.

Marsh declined to comment on the potential charges, but the AG may soon put other companies on the hot seat as well. The office is expected to use tactics similar to those employed in the Marsh case against other brokers: bring civil complaints against companies and criminal charges against individuals. According to sources, the two most likely targets of investigation are Chicago-based Aon Corp. and the New York office of Britain-based Willis Group Holdings Ltd., the industry's next two largest players. Willis and Aon say they have been cooperating fully with Spitzer's probe.

After that, Spitzer wants to take on property-casualty insurers. A spokesman says four companies named in Spitzer's complaint against Marsh as participants in bid-rigging—American International Group,

ACE, Hartford Financial Services Group, and Munich-American RiskPartners—may be named as defendants, though it's unclear at this point what the charges would be. AIG says it does not comment on subpoenas. AIG and Hartford say they are cooperating fully. ACE declined to comment. Munich did not comment. In all, 16 property-casualty insurers have been subpoenaed for information.

Spitzer's net could also soon snare health and life insurers. His team of lawyers in the New York investor-protection bureau is investigating whether benefits managers—brokers who help companies or other large organizations purchase the insurance offered to their employees—have also engaged in alleged misconduct.

The health-insurance investigation is in a preliminary stage. But Hartford-based Aetna Inc. says it received a subpoena from Spitzer's office in September for information regarding broker-compensation issues. Philadelphia-based accident-and-health insurer CIGNA Corp. has also been subpoenaed. Both say they are cooperating fully with Spitzer's investigation.

If he eventually brings charges against health insurers, Spitzer will have reached his original goal: Before he hit upon the rich vein of alleged wrongdoing at Marsh, his aim was to target insurers that rip off the little guy. Along the way, he has managed to plant fear—and possibly the seeds of reform—in an entire industry.

—By Emily Thornton in New York

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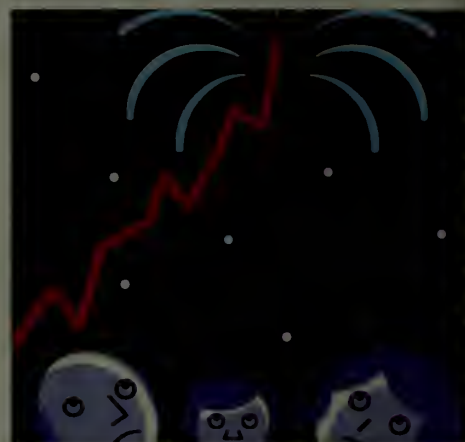
Gains look less torrid

FOR SIX STRAIGHT QUARTERS, Corporate America logged profit gains of 20% or more; in the second quarter alone, earnings rose a jaunty 41%. But amid growing economic headwinds, supercharged profits look to be about to end.

BusinessWeek's flash profit survey of

more than 700 early-filing companies shows that third-quarter income from continuing operations before extraordinary items rose 15% over the previous year, on a 13% sales gain. (For a sample of 78 of those early-filers see the accompanying table.) Those numbers are broadly in line with expectations for the companies in the Standard & Poor's 500-stock index. According to Thomson First Call, analysts figure third-quarter earnings from continuing operations, excluding extraordinary and special items, will rise 15.9%.

Why the sudden drop in profit growth? Rising interest rates, slowing productivity gains, and high commodity prices were widely expected to bite into earnings. But steadily rising crude oil



prices combined with a cooling economic recovery have conspired to hit profit harder than expected. Says Sung Wor Sohn, chief economist at Wells Fargo &

The Third Quarter: No Barn-Burner

	Q3 2004 SALES (MILLIONS)	% CHG. FROM Q3 2003	Q3 2004 PROFITS (MILLIONS)	% CHG. FROM Q3 2003	ANALYSTS' EST. EPS*	REPORTED EPS*	DIFF.		Q3 2004 SALES (MILLIONS)
INDUSTRIALS	361,030.5	+12	29,953.7	+37	0.62	0.64	+0.02		
Alcoa	5,975.0	+13	298.0	+5	0.34	0.34	—	Costco Wholesale †††	15,139.3
Altria Group	15,977.0	+4	2,648.0	+6	1.25	1.24	-0.01	Delta Air Lines	3,871.0
Boeing	13,152.0	+8	438.0	+77	0.40	0.56	+0.16	FedEx †	6,975.0
Caterpillar	7,649.0	+38	498.0	+124	1.36	1.41	+0.05	Gannett	1,815.9
Coca-Cola	5,662.0	0	935.0	-24	0.47	0.50	+0.03	Goldman Sachs Group	6,803.0
Colgate-Palmolive	2,695.7	+7	329.0	-10	0.58	0.58	—	JPMorgan Chase	16,546.0
ConAgra Foods †	3,495.6	+8	133.3	-20	0.26	0.28	+0.02	McDonald's	4,925.7
ConocoPhillips	30,258.0	+34	2,011.0	+61	2.57	2.87	+0.30	McGraw-Hill	1,695.9
DuPont	5,740.0	-7	331.0	NM	0.24	0.25	+0.01	McKesson ††	19,934.3
Eastman Kodak	3,364.0	+1	45.0	-61	0.72	0.79	+0.07	Merrill Lynch	7,595.0
Ford Motor	38,996.0	+6	480.0	+98	0.14	0.28	+0.14	Morgan Stanley	9,854.0
General Electric	38,083.0	+15	4,051.0	+1	0.38	0.38	—	Sears, Roebuck	8,295.0
General Motors	44,858.0	+3	440.0	-2	0.96	0.78	-0.18	Southwest Airlines	1,674.0
Halliburton	4,790.0	+15	186.0	+102	0.36	0.39	+0.03	Union Pacific	3,076.0
International Paper	6,578.0	+9	208.0	+84	0.45	0.43	-0.02	United Parcel Service	8,952.0
Johnson & Johnson	11,553.0	+11	2,341.0	+13	0.76	0.78	+0.02	UnitedHealth Group	9,859.0
Kraft Foods	7,831.0	+5	779.0	-4	0.45	0.48	+0.03	WellPoint Health Networks	5,848.1
Lockheed Martin	8,438.0	+4	307.0	+41	0.65	0.69	+0.04	Wells Fargo	NA
Marathon Oil	11,112.0	+21	222.0	-24	0.93	0.85	-0.08	Yellow Roadway	1,767.1
Merck	5,538.1	-4	1,325.6	-29	0.71	0.60	-0.11	TECHNOLOGY	62,558.0
Nike †	3,561.8	+18	326.8	+25	1.11	1.21	+0.10	Apple Computer †††	2,350.0
PepsiCo	7,257.0	+6	1,364.0	+35	0.65	0.66	+0.01	IBM	23,429.0
Pfizer	12,831.0	+4	3,298.0	+47	0.54	0.55	+0.01	Intel	8,471.0
Procter & Gamble †	13,744.0	+13	2,001.0	+14	0.72	0.73	+0.01	Lucent Technologies †††	2,402.0
Pulte Homes	2,967.1	+24	259.2	+61	2.00	1.99	-0.01	Microsoft †	9,189.0
Schlumberger	2,931.1	+15	297.1	NM	0.53	0.52	-0.01	Motorola	8,624.0
3M	4,969.0	+8	775.0	+17	0.98	0.97	-0.01	Oracle †	2,215.0
United States Steel	3,707.0	+48	354.0	NM	2.05	2.56	+0.51	Sun Microsystems †	2,628.0
United Technologies	9,339.0	+17	722.0	+13	1.41	1.43	+0.02	Texas Instruments	3,250.0
Valero Energy	14,339.3	+45	434.5	+127	1.54	1.57	+0.03	UTILITIES & TELECOM	51,856.0
Weyerhaeuser	5,849.0	+13	594.0	+624	1.40	1.62	+0.22	American Electric Power	3,700.0
Whirlpool	3,318.0	+7	101.0	-4	1.52	1.50	-0.02	AT&T	7,638.0
Wyeth	4,471.8	+10	1,421.3	NM	0.70	0.76	+0.06	AT&T Wireless Services	4,213.0
SERVICES	204,026.1	+16	21,250.4	+3	0.81	0.79	-0.02	BellSouth	5,095.0
ACE	3,072.0	+15	-3.0	NM	0.00	0.07	+0.07	Dominion Resources	3,292.0
AFLAC	3,321.0	+13	301.0	+27	0.57	0.58	+0.01	Exelon	3,865.0
AIG	23,394.8	+27	2,512.5	+8	0.98	0.97	-0.01	Nextel Communications	3,398.0
Allstate	8,442.0	+4	56.0	-92	0.08	0.08	—	SBC Communications	10,292.0
AMR	4,762.0	+3	-214.0	NM	-1.45	-1.33	+0.12	Southern	3,441.0
Bank of America	NA	NA	3,764.0	+29	0.90	0.91	+0.01	Sprint	6,922.0
Citigroup	26,408.0	+13	5,308.0	+13	0.99	1.02	+0.03		

† First-quarter results †† Second-quarter results ††† Fourth-quarter results
Data: Standard & Poor's Compustat

b.: "The higher price of oil is not only hurting consumer spending, it's also hurting company profits." Just ask the airlines, which continued to lose altitude. Delta Air Lines lost \$646 million, while American Airlines parent AMR booked \$214 million in red ink.

Of course, some sectors still defied gravity. Big Oil, with its ample pricing power, promises to be one of the biggest profit machines this quarter. MonocoPhillips, for example, reported a 60% jump in earnings, to \$2 billion.

Analysts polled by Thomson First all expect profits for S&P 500 companies to rise 15.3% in the fourth quarter. Not torrid, but solidly in the black. ■

—By Stephanie Anderson Forest
in Dallas



BETHLEHEM
Mittal is out to buy a cluster of U.S. mills

INDUSTRIES

A NEW GOLIATH IN BIG STEEL

Mittal's deal creates a global powerhouse—and may give buyers less clout on price

LAKSHMI N. MITTAL, THE Indian-born steel tycoon, has built a \$6.4 billion personal fortune on the scraps and remnants of aging steel companies from Algeria to Poland to Mexico. He also knows how to spend the enormous wealth that success has brought him. Last April, Mittal dropped \$128 million on a 12-bedroom neo-classical mansion in London's fashionable Kensington. Two months later, he hosted 1,000 guests in and around Paris for his daughter's weeklong wedding celebration. The festivities included a formal bash at the Palace of Versailles and cost a rumored \$50 million.

But what the 54-year-old Mittal really likes to spend his money on is buying more steel mills. In his biggest move yet, Mittal announced a deal that will create the world's largest steelmaker, with estimated annual revenue of \$31.5 billion.

The two-step transaction first unites Mittal's European companies—Ispat International and LNM Holdings—in a \$13.3 billion merger. The new entity, Mittal Steel Co., will then acquire International Steel Group (ISG) in Richfield, Ohio, for \$4.5 billion. By enlarging Mittal's U.S. holdings with ISG, Wilbur L. Ross Jr.'s collection of once-decrepit but now revamped U.S. steel factories, the transaction unites four of the seven largest old-line U.S. steelmakers that existed in 2001—LTV, Bethlehem Steel, Weirton Steel, and Ispat Inland Steel. Assuming the deal passes regulatory muster, as industry insiders expect, Mittal predicts the transaction will be completed by next April.

The move is almost certain to set off a new wave of global steel consolidation as competitors, such as Luxembourg's Arcelor and South Korea's Posco, seek to match the scale and clout of Mittal Steel. And that raises a key concern for



MITTAL New riches in an old industry

(TOP TO BOTTOM) PHOTOGRAPHS BY AFP/GETTY IMAGES; DANIEL ACKER/BLOOMBERG NEWS

	% CHG. FROM Q3 2003	ANALYSTS' EST. EPS*	REPORTED EPS*	DIFF.
3	+24	0.58	0.62	+0.04
0	NM	-4.38	-4.73	-0.35
0	+158	1.08	1.08	—
2	+11	1.19	1.18	-0.01
0	+30	1.43	1.74	+0.31
0	-13	0.74	0.60	-0.14
4	+42	0.61	0.61	—
5	+12	1.56	1.69	+0.13
1	-45	0.24	0.29	+0.05
0	-8	0.92	0.93	+0.01
0	-17	0.95	0.76	-0.19
0	NM	0.01	-0.29	-0.30
0	+12	0.12	0.15	+0.03
0	-33	0.75	0.77	+0.02
0	+20	0.72	0.70	-0.02
0	+47	1.00	1.04	+0.04
1	+28	1.91	1.97	+0.06
0	+12	1.06	1.02	-0.04
9	+222	1.34	1.38	+0.04
0	+22	0.23	0.25	+0.02
0	+159	0.18	0.27	+0.09
0	+1	1.14	1.17	+0.03
0	+15	0.27	0.30	+0.03
0	+252	0.04	0.04	—
0	+11	0.30	0.31	+0.01
0	+313	0.19	0.20	+0.01
0	+16	0.09	0.10	+0.01
0	NM	-0.03	0.00	+0.03
0	+26	0.27	0.32	+0.05
0	NM	0.40	0.42	+0.02
0	+75	0.74	0.80	+0.06
0	NM	0.51	0.75	+0.24
0	-25	0.02	0.04	+0.02
0	-5	0.51	0.49	-0.02
0	NM	1.32	1.21	-0.11
0	NM	0.90	0.92	+0.02
0	+69	0.38	0.39	+0.01
0	+5	0.38	0.38	—
0	+4	0.87	0.87	—
0	NM	0.21	0.24	+0.03

not meaningful NA = not available
*Estimated and reported EPS data provided by Thomson First Call

U.S. manufacturers: whether the emergence of Mittal as a global steel powerbroker will limit their ability to bargain on price. For now, however, the big question is whether Mittal, which has been so successful at resurrecting aged steel mills in mostly developing and former Soviet bloc countries, will thrive in the far more competitive U.S. market.

Mittal has rarely made a misstep before. Like Ross, he's a big risk taker who has proven that new money can be made from an old industry. Shopping around the world whenever steel mills come on the market, Mittal has built a powerhouse that stretches from Europe to Africa and Latin America. He has been able to generate profits by using his scale to buy lower-cost raw materials and by importing modern management techniques into previously inefficient state-run mills.

DWARFING RIVALS

NOW, THOUGH, THE BAR is much higher. ISG's operations have already had huge costs wrung out by Ross. To buy them, Mittal paid \$42 a share, a 42% premium. But Mittal argues this money is well spent because the consolidation will deliver better economies of scale. For example, the new company will own three mills clustered on Lake Michigan, making it easier to centralize management, consolidate material delivery, and optimize what each plant makes. Thanks to its size, the combined company will have access to larger, lower-cost supplies of ore, coke, and coal. "We already run the lowest-cost, highest profit mills in the U.S.," says Mittal. "ISG isn't there yet, but we can get them there."

Mittal Steel's rise opens a new chapter in the industry's consolidation. Till now, the game has been mostly regional—with U.S. and European players tending to merge in their respective markets. Mittal's move globalizes this trend. The world's top producers have little choice but to bulk up to match Mittal Steel's post-merger output of 57 million metric tons. That dwarfs the output of the No. 2. and No. 3 players: Luxembourg's Arcelor is on track to pour 43 million metric tons, and South Korea's Posco is likely to produce 30.5 million metric tons. Plus, neither has a substantial presence in the U.S. "They'll have to look overseas to match [Mittal Steel's] global

THE STAT

\$31.5
BILLION

Estimated 2004 revenue of Mittal Group if a deal for ISG is done—making Mittal the world's largest steel producer

Data: LNM Group

quickly, they risk being taken over, most likely by foreign makers seeking a U.S. footprint. Within five years, predicts Locker, the highly fragmented world steel market will be dominated by six or so "super producers." Today, only Mittal Steel has entered that league.

Fewer steel sources also means higher

reach," says Michael Locker, president of consultants Locker Associates Inc.

The shakeup spells uncertainty for the remaining U.S. producers. With annual output of around 20 million metric tons each, U.S. Steel and Nucor are big fish at home. But globally, their production levels put them in a second tier with only minor international presence. If they don't grow

prices are likely. That's bad news for buyers, who have seen prices climb steadily since 2003. Analysts expect that carmaker will have to pony up 20% more for new steel contracts running through next year. That would increase the average cost to produce a vehicle by \$174, according to UBS Securities. Ispat, Mittal's existing U.S. unit, already has a hard-nosed reputation. The company recently hiked rates to Whirlpool Corp. causing the appliance maker to boost its prices by as much as 10% in September. Says Chairman and CEO Jeff M. Fettig: "I don't think any company can overcome that magnitude of raw material price increases with productivity

If Whirlpool's experience with Mittal is an indication of what's to come, the tycoon from India will have plenty more cash to spend on lavish parties—and U.S. manufacturers may have one more problem to worry about. ■

—By Adam Aston in New York and Michael Arndt in Chicago, with Manjeet Kripalani in Bombay and Laura Cohn in London

STRATEGIES

Melting Away Steel's Costs

When financier Wilbur L. Ross Jr. got into the steel industry three years ago, he didn't have to spend much. Shopping the nation's bankruptcy courts, Ross and his co-investors picked up the assets of five producers, including giants Bethlehem Steel Corp. and LTV Corp., for \$2.1 billion, and melded them into International Steel Group Inc.

So what makes these cast-offs worth \$4.5 billion today to London-based steel tycoon Lakshmi N. Mittal? A resurgent industrial economy and a much-shrunk payroll explains part of it. But what really makes ISG so valuable is that it has shed the legacy costs that burden other old-line manufacturers. Through bankruptcy, Ross shifted \$14 billion in pensions to the Pension Benefit Guaranty Corp. (PBGC), which is backed by the federal government. He also passed off more than \$5.9 billion in retiree health-care costs onto either the former workers themselves or Medicare.

The transfers were entirely legal. Indeed, the United Steelworkers of America endorsed the retiree-benefit cutbacks as the price of maintaining jobs at the bankrupt steel mills. For now, the PBGC has been able to pick up its new obligations through fees on other defined-benefit pension plans. But the PBGC is warning that if major airlines follow Ross's course, it may soon be overwhelmed and have to turn to taxpayers for money.

For his three years of labor in steel, Ross is personally pocketing \$300 million, while his investors sock away up to \$2.1 billion. Says Ross: "We did fine." Successful in steel, Ross is now trying his hand in the coal industry. He has formed a new company, International Coal Group, by buying assets of three bankrupt mines. And in September, he won court approval to hand off \$132 million in pension obligations of one of these companies, Horizon Natural Resources Co., to the PBGC. When you've got a winning strategy, why change it?

—By Michael Arndt in Chicago



ROSS Next up: Coal producers

ÜBER AUTO

Der 2005 Lexus RX 330.
Fantastisch! p. 42



Der Kurier



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Domani



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l'Espresso



Die Straße



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COMMENTARY

BY PAUL MAGNUSSON

Will All Those New Voters Show Up?

Democrats have more registrations. But the GOP is planning a massive final push

BENEATH THE money and the mudslinging, the 2004 Presidential race is turning out to be a high school civics teacher's dream come true. A once-apathetic public appears poised for a huge turnout, thanks to a monumental voter-registration effort by the two major parties and their supporters. Voters could number 118 million to 121 million, a big jump

from the 106 million who voted in 2000, predicts Curtis Gans, director of the Committee for the Study of the American Electorate. Just reaching the 118 million mark would match the intensity of the last big upswing, in 1992, when 58% of eligible voters turned out. Hitting the high end of Gans's estimate would approach the record '60s era when battles over civil rights and the Vietnam War drew a horde of new voters.

The big question, of course, is how the potentially huge turnout will affect the outcome. Democrats say that if the jump in registrations leads to a massive turnout, they will win. Republicans, not surprisingly, insist it's not that simple: Quality counts, too. Many newly minted Democrats either faked their registrations or won't show up, they say.

If past patterns hold true, droves of voters could well sink the GOP's hopes. "If [turnout] is extremely high, we're looking at occasional voters, swing voters, independents—and every poll has those breaking toward Kerry," says political scientist Michael P. McDonald of George Mason University in Fairfax, Va. Indeed, an Oct. 14 Gallup Poll found that 12% of all registered voters say this will be their first Presidential vote—and that these newbies favored Senator John Kerry over President George W. Bush by a 50% to 35% margin. Polls from Harvard University's Institute of Politics bear out the pro-Dem trend for young new voters.

Democrats and their allies have targeted the 16 million Americans who've turned 18 since 2000, a bloc Kerry has wooed with warnings about a new draft. Meanwhile, pro-Democratic groups have also focused on their traditional constituencies: urban voters, par-

ticularly minorities; union members; and the working class. In Arizona, Project Vote has signed up 75,000 voters by concentrating on low-turnout precincts where more than half the population is Latino. New registrants will get four more visits from one of 100 paid canvassers, all hired from the neighborhood, to remind them where to go on Election Day. "We'll give them a ride to the polls or a babysitter or whatever it takes," vows state director Debbie Lopez. Nationally, the nonpartisan Project Vote has registered 1,096,777 new voters in the past year, mostly in low-income and minority communities, says national director David Leland.

Republicans have adopted a centralized approach, relying more on party loyalists and volunteers than paid canvassers. They say they've signed up 3.4 million new voters. "We've gone after real people while the Democrats have just outsourced the ground game and picked up a lot of frauds like Dick Tracy and Mary Poppins," says Jim Dyke, Republican National Committee communications director. The GOP is also honing its successful "72-hour campaign" from 2002, a final push deploying 1.6 million volunteers to battleground states to knock on doors, staff phone banks, and arrange transportation to make sure new registrants show up at the polls. Business allies and evangelical Christians will add to that effort.

Even with those tallies, Republicans concede that Democrats have racked up far bigger numbers. "The word is that the Democrats have simply registered more new voters than we have," says a senior Republican strategist. But Ken Mehlman, Bush's campaign manager, insists a centralized GOP effort staffed by party loyalists will produce better results.

Whose voters will actually show up on Nov. 2, especially in the 10 or so critical swing states? Some 80% of new registrants have told pollsters they will turn out on Election Day, but young voters in particular are notoriously distracted by such concerns as overdue term papers, bad weather, or good parties. Only 28.6% of the 18-to-24 crowd voted in 2000, versus 58% of all registered voters. Working-class people sometimes face the choice between standing in line to vote and being docked an hour's pay. Cars have flats; babies won't nap. Is your high school civics teacher's dream, such distractions never interfere with good citizenship. In Campaign 2004, it'll be up to the armies of activists to overcome them. ■

—With Lorraine Woellert, Paula Dwyer, and Lee Walczak in Washington



THE STAT

118-121

MILLION

Voter turnout forecast this year, up from 105.6 million in 2000

Data: Committee for the Study of the American Electorate

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MEDIA

SATELLITE RADIO SHOOTS THE MOON

Dueling XM and Sirius are betting huge sums, but profits are still far off

THE SATELLITE RADIO wars are heating up. Every week seems to bring another attempt by XM Satellite Radio Holdings Inc. and Sirius Satellite Radio Inc. to outdo each other. On Oct. 6, Sirius announced it had lured shock jock Howard Stern from broadcast radio in an exclusive five-year, \$500 million cash and stock deal that starts in 2006. Two weeks later, XM counterpunched, announcing a \$650 million, 11-year deal to air Major League Baseball.

In a matter of a month, XM and Sirius have together committed more than \$1 billion for programming, in an all-out effort to entice listeners to pay \$10 to \$13 a month for their services. That's a lot of loot for a pair of companies that have yet to make a dime in profits. As if a reminder was necessary, on Oct. 27 Sirius reported that its third-quarter net loss widened by nearly 60% to \$169.4 million.

Are the two satellite radio pioneers overreaching? While analysts don't expect either company to generate profits until 2008 at the earliest, they argue that the combination of more compelling programming and the increasing ubiquity of the radios in new car models could help turn satellite radio into a viable media

business. Investors seem to agree: XM's stock price surged 70% over past 12 months, to \$32.50, while Sirius, with a much smaller market cap, has more than doubled, to about \$4. Satellite radio, says Anthony Valencia, a media analyst at L.A.-based TCW Group, one of XM's top institutional investors, "is affordable, and with its content and choice, more people over time will subscribe to the service."

Can XM and Sirius survive long enough to lure a critical mass of subscribers? Both companies have taken on plenty of debt to finance the programming sorties. XM now has \$710 million of debt on its books; Sir-

SIRIUS JOCK
The company has a cushion of \$800 million

ius \$426 million. Both also have plenty of cash. Sirius has tapped the capital markets eight times in the past

months and is now sitting on a cushion of more than \$800 million; XM has a cash hoard of \$377 million. And so far the burn rate seems sustainable: SG Cowen & Co. expects XM to go through about \$200 million over the next two years. What's more, analysts say, both companies have probably completed their most expensive programming deals.

STERN'S FANS

GETTING THE programming right will be key. That's where Stern comes in. He draws about 12 million loyal listeners from more than 40 cities, and analysts believe Sirius will need to sign up just 1.7 million of those fans to break even on its investment by 2007. For its part, XM is betting on the MLB deal to draw folks who want to listen to games that aren't available on local radio. XM, which expects to have 1 million subscribers by yearend, will need to lure 1.6 million more to break even over the 11-year term of the MLB deal, reckons Bear, Stearns & Co. analyst Robert Peck.

Just as important will be persuading auto makers to make satellite radio standard. Right now XM has the edge, with radios in 103 models. General Motors Corp., which owns 5.2% of the company, offers the radios as an option in 90% of its North American models. Honda Motor Co., which holds an 8.2% stake, has installed the technology in eight models. By contrast, Sirius will be in 50 DaimlerChrysler, BMW, and Volkswagen models by yearend. Ford Motor, meanwhile, expects to have Sirius radios in 20 models within two years. On high-end models, the technology is standard at no extra cost to the buyer, while on many vehicles satellite radio is part of a package that often includes a CD player and sunroof.

XM and Sirius believe that with 200 million cars and light trucks on U.S. roads and roughly 16 to 18 million new vehicles sold each year, the potential market for satellite radio is huge. And with 57% of the folks who buy satellite radio-equipped models signing up for the service, they could be right. ■

—By Tom Lowry
New York, with Catherine Yang in Washington and a bureau reporter

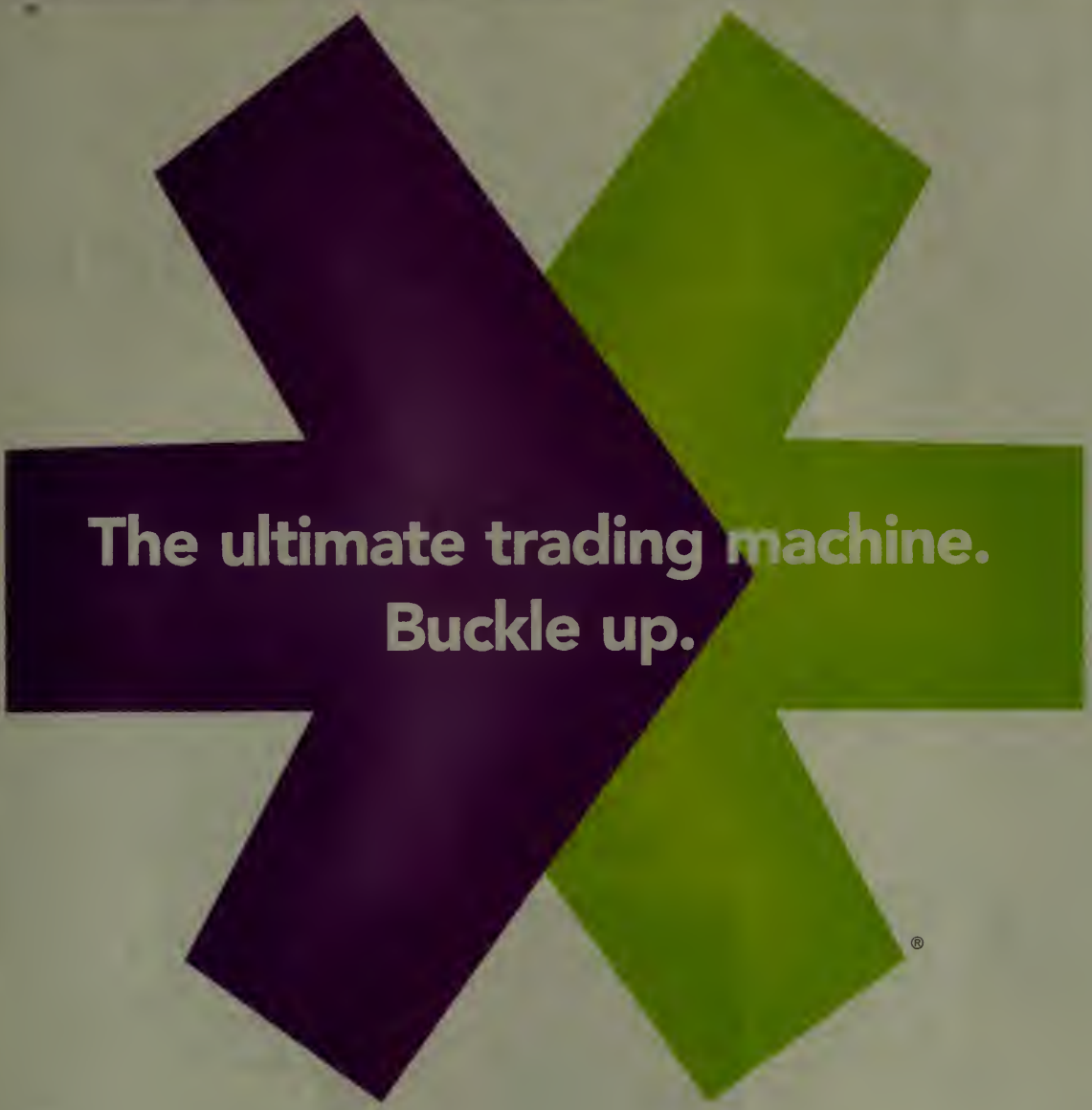
Radio Days

Is there enough demand for two competing satellite services? A look at the players:

2004 Estimates		
-\$607 million	Net Loss	-\$593 million
\$71 million	Revenue	\$242 million
\$426 million	Debt	\$710 million
\$6 billion	Market cap	\$10 billion
950,000	Subscribers	3.12 million
\$12.95	Monthly subscription fee	\$9.99
\$200	Subscriber acquisition cost*	\$65

*for each new subscription

Data: Bear, Stearns & Co. Inc.



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COMMENTARY

BY PETER BURROWS

Can the iPod Keep Leading the Band?

Apple has to continue to out-innovate a growing crowd of contenders

BY THE TIME guests arrived at a well-hyped product unveiling by Apple Computer Inc. on Oct. 26, the big news had leaked: U2's Bono would be on hand to introduce a special black version of the iPod music player. But Apple Chief Executive Steven P. Jobs had other news: a new, slightly thicker, pricier iPod that not only plays music but also stores and displays digital

photos. "We're not standing still," Jobs said.

That bodes well for a big iPod Christmas—and for Apple's chances of maintaining its dominance for some time to come. Although they haven't much dented the iPod's appeal so far, a horde of rivals, including Dell, Sony, Virgin Electronics, and Samsung Group, will offer north of 100 iPod wannabes this holiday season. Moreover, Microsoft Corp. recently announced new technologies that allow most of these products to work with dozens of online music services that compete with Apple's iTunes Music Store.

For now, Apple's continued innovation—with its red-hot brand, expanding chain of retail stores, and a burgeoning market for add-ons—looks likely to lead to a long, prosperous run. Eventually, though, Jobs faces a tough choice: Should he keep the iPod's proprietary system closed, or would Apple be better able to maintain its lead by licensing its technology to all comers?

Whatever Apple's current technological lead, history is not on its side. Although it increased its share of the digital music player market to 66% in August, according to NPD Group Inc., up from 28% the year before, many a tech pioneer has seen its early dominance wither. Just look at Palm in PDAs, Nintendo in game consoles, and Apple itself in PCs. Already, rival music players offer more features at lower prices (page 146). "It's a nascent market, and [Apple's lead] is not sustainable," says Dave Fester, general manager of Microsoft's Windows digital media division.



"Music-plus-photos will be the next big thing," Jobs says

But Apple has significant advantages this time. For one, millions of consumers have invested in some of the 200-plus iPod accessories, from \$19 pink plastic cases to \$300 portable stereos from Bose Corp. Add-on makers such as speaker-maker Alto Lansing say well over 10% of iPod buyers also buy their products at many stores. BMW has sold 12,000 adapters to integrate the iPod into its sound system, and there's a long waiting list. "We can't keep them in stock," says James L. McDowell, vice-president of marketing for BMW North America. These add-ons not only draw customers to the iPod instead of rivals, they could also lock them in for the long haul—just as the availability of thousands of Windows programs helped bury Apple in PCs.

Of course, all that will help only if the iPod continues to offer innovative features that keep it ahead of rivals. So far, Apple has

BACK IN BLACK
Bono and Jobs with the new special edition

successfully created several versions of the iPod since it was launched in 2001, including the more affordable Mini.

While the new iPod Photo, at \$600, is likely to appeal mostly to well-heeled shutterbugs, it may hint at much broader digital media play. Since the iPod can be hooked up to a TV or stereo, says NPD analyst Stephen Baker, why not develop one that stores music videos that can be played on big living room screens as well. And however whimsical the U2 iPod may seem, if it's a hit, Apple could quickly do similar deals with other artists. Another possibility: Analysts expect Apple eventually to field an iPod that uses cheaper flash memory instead of a hard drive. While flash devices

hold only a few dozen songs, at less than \$200 they represent nearly a third of the market for digital music players.

Still, as rivals' technology catches up, Jobs may eventually have to open up the iPod's closed world to maintain his lead. He would face a tough choice, either one of which could undercut Apple's own hardware sales: Should he license the guts of the iPod, allowing lower cost clones to flourish? Or should he license the antipiracy software in Apple's iTunes Music Store so that other players work with it?

Those are the kinds of open approaches Apple refused to take with the Mac back in the 1980s—a decision that relegated the Mac to a tiny niche. With the iPod, Jobs has proved himself capable of thinking different; already, he is letting Hewlett-Packard resell and accessorize the music player. Apple won't be able to catch the shots forever, but if Jobs plays his cards right, the iPod may dominate longer than its rivals imagine. ■



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A STAR ALLIANCE MEMBER



EDITED BY MONICA GAGNIER

HEADLINER

SCOTT
MCGREGOR



HELLO, MR. CHIPS

When legendary **Broadcom** CEO Henry Nicholas III stepped down in 2003, many wondered how the chipmaker would ever replace him. After co-founding the company in 1991, Nicholas built Broadcom into one of the largest makers of chips that power consumer-electronics and communications gear.

It took nearly two years, but on Oct. 26, Broadcom finally selected a permanent successor: Scott McGregor, 48, previously CEO of Philips Semiconductors. McGregor replaces interim chief Alan Ross.

McGregor joins Broadcom at a critical time. In the first nine months of this year, sales jumped 65%, to \$1.9 billion, and it swung from a loss of \$965.9 million to a profit of \$152.7 million. But Broadcom is facing a slowdown in sales as it works through excess inventory. That puts pressure on McGregor to find new markets. And there's little doubt Nicholas will be looking over his shoulder: The ex-CEO owns enough shares to give him more than 30% of Broadcom's voting power.

—Arlene Weintraub

NOW, THAT'S SOME IPO

Consumers may love bargains, but they sure shelled out for **Shopping.com's** initial public offering. On Oct. 26, the Web comparison-shopping site saw its stock jump 60%, to \$28.80 a share, and it rose 10% the next day. It was the second attempt to go public this year by the Israel-based company, which postponed its offering in June when the IPO market slowed. But the phenomenal 114% rise of search engine **Google's** stock since its Aug. 19 IPO cleared the way for Shopping.com's stock market debut. It also seems to have persuaded investors to ignore a warning in Shopping.com's prospectus. Some investors in **Epinions**, an online product review company it bought last year, contend they were misled about growth and may seek damages of more than \$70 million.

BLOCKBUSTER OF AN EXIT



On Oct. 27, **Blockbuster** President and Chief Operating Officer Nigel Travis unexpectedly announced he will leave the video-rental company by yearend. The same day, Blockbuster reported a third-quarter loss of \$1.42 billion and warned fourth-quarter profits would "decline

significantly" as it combats sales of cheap DVDs at retailers like **Wal-Mart Stores** and the success of video-by-mail operators such as **Netflix**. Travis was unavailable for comment, but Chairman and Chief Executive John Antioco attributed his departure to managerial ambition. After Antioco recently signed a new five-year employment contract, "the opportunity [Travis] wanted wasn't likely to occur here," Antioco says.

FROM POSH TO PENNEY'S

Midpriced department store chain **J.C. Penney** has again gone upscale for a new leader. On Oct. 27, Penney unexpectedly named Myron Ullman III chairman and CEO, effective Dec. 1. A 15-year retail veteran, Ullman, 57, most recently was a senior executive at luxury retailer **LVMH Moët Hennessy Louis Vuitton**. He will replace Allen Questrom, a former Barneys New York CEO who joined Penney in 2000 to spearhead a turnaround at the retailer. Questrom had said that he would stay at Penney for only five years. Industry observers had widely expected Vanessa Castagna, Penney's CEO of stores, catalog, and Internet, to succeed him.

A HEDGE-FUND WATCHDOG

The **Securities & Exchange Commission** approved a rule that brings the hedge-fund industry under its eye for the first time. On Oct. 26, the commission voted 3-2 to require hedge-fund managers to register with the SEC. The rule will let the agency inspect hedge funds' books and records. It also will force hedge funds to appoint compliance officers and raise

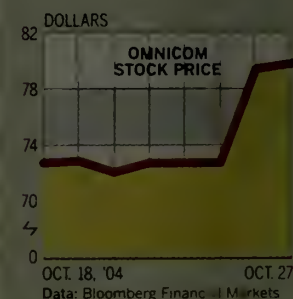
the wealth threshold for investors in most of these private-equity pools to \$1.5 million. Although about 40% of hedge-fund managers already have registered voluntarily with the SEC, the industry fought the rule. Now some managers, including Phillip Goldstein, who runs Opportunity Partners, plan to challenge the SEC's authority to regulate the industry.

ET CETERA...

- » **ATA Airlines** declared bankruptcy on Oct. 26.
- » **Nortel** delayed the release of its restated financial statement until November.
- » **Boeing** posted a 78% jump in quarterly earnings that beat Wall Street forecasts.

CLOSING BELL

Madison Avenue got some good news on Oct. 26 as **Omnicom** shares rose 9%, to \$79.44. The ad agency holding company outdistanced Wall Street's estimates with a 17% gain in third-quarter earnings, thanks to a boost from Summer Olympics advertising.



IMPORTANT SAFETY AND DOSING INFORMATION

LEVITRA is a prescription medicine that is used to treat erectile dysfunction (ED). Men taking nitrate drugs, often used to control chest pain (also known as angina), should not take LEVITRA. Men who use alpha blockers, sometimes prescribed for high blood pressure or prostate problems, also should not take LEVITRA. Such combinations could cause blood pressure to drop to an unsafe level. You should not take LEVITRA if your doctor determines that sexual activity poses a health risk for you. Men who experience an erection for more than four hours should seek immediate medical attention. LEVITRA does not protect against sexually transmitted diseases. The starting dose of LEVITRA is 10 mg taken no more than once per day. Your doctor will decide the dose that is right for you. In patients taking certain medications such as ritonavir, indinavir, ketoconazole, itraconazole, and erythromycin, lower doses of LEVITRA are recommended, and time between doses of LEVITRA may need to be extended. In clinical trials, the most commonly reported side effects were headache, flushing, and stuffy or runny nose. LEVITRA is available in 2.5-mg, 5-mg, 10-mg, and 20-mg tablets.

SEE NEXT PAGE FOR ADDITIONAL IMPORTANT PATIENT INFORMATION.



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08669034IP

8/03

Read the Patient Information about LEVITRA before you start taking it and again each time you get a refill. There may be new information. You may also find it helpful to share this information with your partner. This leaflet does not take the place of talking with your doctor. You and your doctor should talk about LEVITRA when you start taking it and at regular checkups. If you do not understand the information or have questions, talk with your doctor or pharmacist.

WHAT IMPORTANT INFORMATION SHOULD YOU KNOW ABOUT LEVITRA?

LEVITRA can cause your blood pressure to drop suddenly to an unsafe level if it is taken with certain other medicines. With a sudden drop in blood pressure, you could get dizzy, faint, or have a heart attack or stroke.

Do not take LEVITRA if you:

- take any medicines called "nitrates"
- use recreational drugs called "poppers" like amyl nitrate and butyl nitrate.
- take medicines called alpha-blockers. (See "Who Should Not Take LEVITRA?")

Tell all your healthcare providers that you take LEVITRA. If you need emergency medical care for a heart problem, it will be important for your healthcare provider to know when you last took LEVITRA.

WHAT IS LEVITRA?

LEVITRA is a prescription medicine taken by mouth for the treatment of erectile dysfunction (ED) in men.

ED is a condition where the penis does not harden and expand when a man is sexually excited, or when he cannot keep an erection. A man who has trouble getting or keeping an erection should see his doctor for help if the condition bothers him. LEVITRA may help a man with ED get and keep an erection when he is sexually excited.

LEVITRA does not:

- cure ED
- increase a man's sexual desire
- protect a man or his partner from sexually transmitted diseases, including HIV. Speak to your doctor about ways to guard against sexually transmitted diseases.
- serve as a male form of birth control

LEVITRA is only for men with ED. LEVITRA is not for women or children. LEVITRA must be used only under a doctor's care.

HOW DOES LEVITRA WORK?

When a man is sexually stimulated, his body's normal physical response is to increase blood flow to his penis. This results in an erection. LEVITRA helps increase blood flow to the penis and may help men with ED get and keep an erection satisfactory for sexual activity. Once a man has completed sexual activity, blood flow to his penis decreases, and his erection goes away.

WHO CAN TAKE LEVITRA?

Talk to your doctor to decide if LEVITRA is right for you.

LEVITRA has been shown to be effective in men over the age of 18 years who have erectile dysfunction, including men with diabetes or who have undergone prostatectomy.

WHO SHOULD NOT TAKE LEVITRA?

Do not take LEVITRA if you:

- take any medicines called "nitrates" (See "What important information should you know about LEVITRA?"). Nitrates are commonly used to treat angina. Angina is a symptom of heart disease and can cause pain in your chest, jaw, or down your arm. Medicines called nitrates include nitroglycerin that is found in tablets, sprays, ointments, pastes, or patches. Nitrates can also be found in other medicines such as isosorbide dinitrate or isosorbide mononitrate. Some recreational drugs called "poppers" also contain nitrates, such as amyl nitrate and butyl nitrate. Do not use LEVITRA if you are using these drugs. Ask your doctor or pharmacist if you are not sure if any of your medicines are nitrates.
- take medicines called "alpha-blockers." Alpha-blockers are sometimes prescribed for prostate problems or high blood pressure. If LEVITRA is taken with alpha-blockers, your blood pressure could suddenly drop to an unsafe level. You could get dizzy and faint.
- have been told by your healthcare provider to not have sexual activity because of health problems. Sexual activity can put an extra strain on your heart, especially if your heart is already weak from a heart attack or heart disease.
- are allergic to LEVITRA or any of its ingredients. The active ingredient in LEVITRA is called vardenafil. See the end of this leaflet for a complete list of ingredients.

WHAT SHOULD YOU DISCUSS WITH YOUR DOCTOR BEFORE TAKING LEVITRA?

Before taking LEVITRA, tell your doctor about all your medical problems, including if you:

- have heart problems such as angina, heart failure, irregular heartbeats, or have had a heart attack. Ask your doctor if it is safe for you to have sexual activity.
- have low blood pressure or have high blood pressure that is not controlled.
- have had a stroke
- or any family members have a rare heart condition known as prolongation of the QT interval (long QT syndrome)
- have liver problems
- have kidney problems and require dialysis
- have retinitis pigmentosa, a rare genetic (runs in families) eye disease
- have stomach ulcers
- have a bleeding problem
- have a deformed penis shape or Peyronie's disease
- have had an erection that lasted more than 4 hours
- have blood cell problems such as sickle cell anemia, multiple myeloma, or leukemia

CAN OTHER MEDICATIONS AFFECT LEVITRA?

Tell your doctor about all the medicines you take, including prescription and non-prescription medicines, vitamins, and herbal supplements. LEVITRA and other medicines may affect each other. Always check with your doctor before starting or stopping any medicines. Especially tell your doctor if you take any of the following:

- medicines called nitrates (See "What important information should you know about LEVITRA?")
- medicines called alpha-blockers. These include Hytrin® (terazosin HCl), Flomax® (tamsulosin HCl), Cardura® (doxazosin mesylate), Minipress® (prazosin HCl) or Uroxatral® (alfuzosin HCl).
- medicines that treat abnormal heartbeat. These include quinidine, procainamide, amiodarone and sotalol.
- ritonavir (Norvir®) or indinavir sulfate (Crixivan®)
- ketoconazole or itraconazole (such as Nizoral® or Sporanox®)
- erythromycin
- other medicines or treatments for ED

HOW SHOULD YOU TAKE LEVITRA?

Take LEVITRA exactly as your doctor prescribes. LEVITRA comes in different doses (2.5 mg, 5 mg, 10 mg, and 20 mg). For most men, the recommended starting dose is 10 mg. Take LEVITRA no more than once a day. Doses should be taken at least 24 hours apart. Some men can only take a low dose of LEVITRA because of medical conditions or medicines they take. Your doctor will prescribe the dose that is right for you.

If you are older than 65 or have liver problems, your doctor may start you on a lower dose of LEVITRA.

If you are taking certain other medicines your doctor may prescribe a lower starting dose and limit you to one dose of LEVITRA in a 72-hour (3 days) period.

Take 1 LEVITRA tablet about 1 hour (60 minutes) before sexual activity. Some form of sexual stimulation is needed for an erection to happen with LEVITRA. LEVITRA may be taken with or without meals.

Do not change your dose of LEVITRA without talking to your doctor. Your doctor may lower your dose or raise your dose, depending on how your body reacts to LEVITRA.

If you take too much LEVITRA, call your doctor or emergency room right away.

WHAT ARE THE POSSIBLE SIDE EFFECTS OF LEVITRA?

The most common side effects with LEVITRA are headache, flushing, stuffy or runny nose, indigestion, upset stomach, or dizziness. These side effects usually go away after a few hours. Call your doctor if you get a side effect that bothers you or one that will not go away.

LEVITRA may uncommonly cause:

- an erection that won't go away (priapism). If you get an erection that lasts more than 4 hours, get medical help right away. Priapism must be treated as soon as possible or lasting damage can happen to your penis including the inability to have erections.
- vision changes, such as seeing a blue tinge to objects or having difficulty telling the difference between the colors blue and green. These are not all the side effects of LEVITRA. For more information, ask your doctor or pharmacist.

HOW SHOULD LEVITRA BE STORED?

- Store LEVITRA at room temperature between 59° and 86° F (15° to 30° C).
- Keep LEVITRA and all medicines out of the reach of children.

GENERAL INFORMATION ABOUT LEVITRA.

Medicines are sometimes prescribed for conditions other than those described in patient information leaflets. Do not use LEVITRA for a condition for which it was not prescribed. Do not give LEVITRA to other people, even if they have the same symptoms that you have. It may harm them.

This leaflet summarizes the most important information about LEVITRA. If you would like more information, talk with your healthcare provider. You can ask your doctor or pharmacist for information about LEVITRA that is written for health professionals.

For more information you can also visit www.LEVITRA.com, or call 1-866-LEVITRA.

WHAT ARE THE INGREDIENTS OF LEVITRA?

Active Ingredient: vardenafil hydrochloride

Inactive Ingredients: microcrystalline cellulose, crospovidone, colloidal silicon dioxide, magnesium stearate, hypromellose, polyethylene glycol, titanium dioxide, yellow ferric oxide, and red ferric oxide.

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EDITED BY RICHARD S. DUNHAM

With Oil Over \$50, Nukes Are Back

NOT LONG AGO, NUCLEAR POWER in the U.S. seemed dead, buried by memories of Three Mile Island, Chernobyl, and mammoth cost overruns that pushed utilities to the brink of bankruptcy. But as the price of oil soars, the onetime pariah is making a comeback.

With a barrel of crude hitting a record \$55 on Oct. 25, more

Americans are coming to see nuclear energy as a cost-effective and environmentally acceptable alternative to fossil fuels, which could boost national security by reducing dependence on Middle East oil. Now, with the existing 103 nuke plants operating longer, more cheaply, and safer than before, the industry is planning the once unthinkable—building the first new nuclear facility in 30 years. And that plan will get a big boost from Uncle Sam: By the end of the year, the Energy Dept. is expected to announce it will pay half the estimated \$500 million cost of detailed design and engineering work that two consortiums need to win approval for new nukes.

Low-Carb Diet

THERE'S MORE good news ahead for nukes in Washington. Energy is also expected to request proposals to build an experimental advanced reactor in Idaho. And if and when Congress passes an energy bill, it will include tax incentives for new nukes. Instead of digging more coal, sending troops overseas to protect oil fields, and paying soaring energy prices, the U.S. "must put nuclear power back on track," says Senate Energy Committee Chairman Pete V. Domenici (R-N.M.).

Selling that argument to pro-environment Democrats long worried about plant safety is easier because oil is so expensive and the cost of producing electricity at nuclear plants has dropped 50% since 1988, thanks to more efficient operations. And with Russia's Oct. 22 ratification of the Kyoto Protocol on climate change, the world

is rapidly moving toward mandatory limits on carbon emissions to combat global warming. Atom-splitting emits no CO₂. "I don't see how we can have low-carbon energy without a new generation of nuclear plants," says CEO John W. Rowe of the Chicago-based utility Exelon. Even many environmentalists agree that nuclear power is essential to any global warming solution. "Nuclear power has turned into a successful business with growing political support," says Roger Gale, chief executive of utilities consultant GF Energy.

But while China and South Africa are moving ahead with a new generation of nukes, there's still a long and uncertain road ahead before construction starts in the U.S. Utilities and plant builders expect to complete designs and apply for licenses from the Nuclear Regulatory Commission by 2008. Then they figure the NRC will take two years to review the applications, so nothing could happen before 2010. And there's still a huge hurdle: what to do with nuclear waste.

A repository for spent fuel under Yucca Mountain in Nevada was supposed to be the answer. But some scientists fear the geology isn't stable enough, and Senator Harry M. Reid (D-Nev.) and Democratic Presidential nominee John Kerry vow to stop the Bush Administration's Yucca plans. Proponents like Domenici think they have the votes to defeat Reid, and they hope that Kerry, if elected, will back off, as George W. Bush did four years ago. If they succeed, the atom could be back—with a surprisingly bigger role in America's energy future. ■

—By John Carey, with Michael Arndt in Chicago



POWER PLANT
New reactors are in the works

CAPITAL WRAPUP

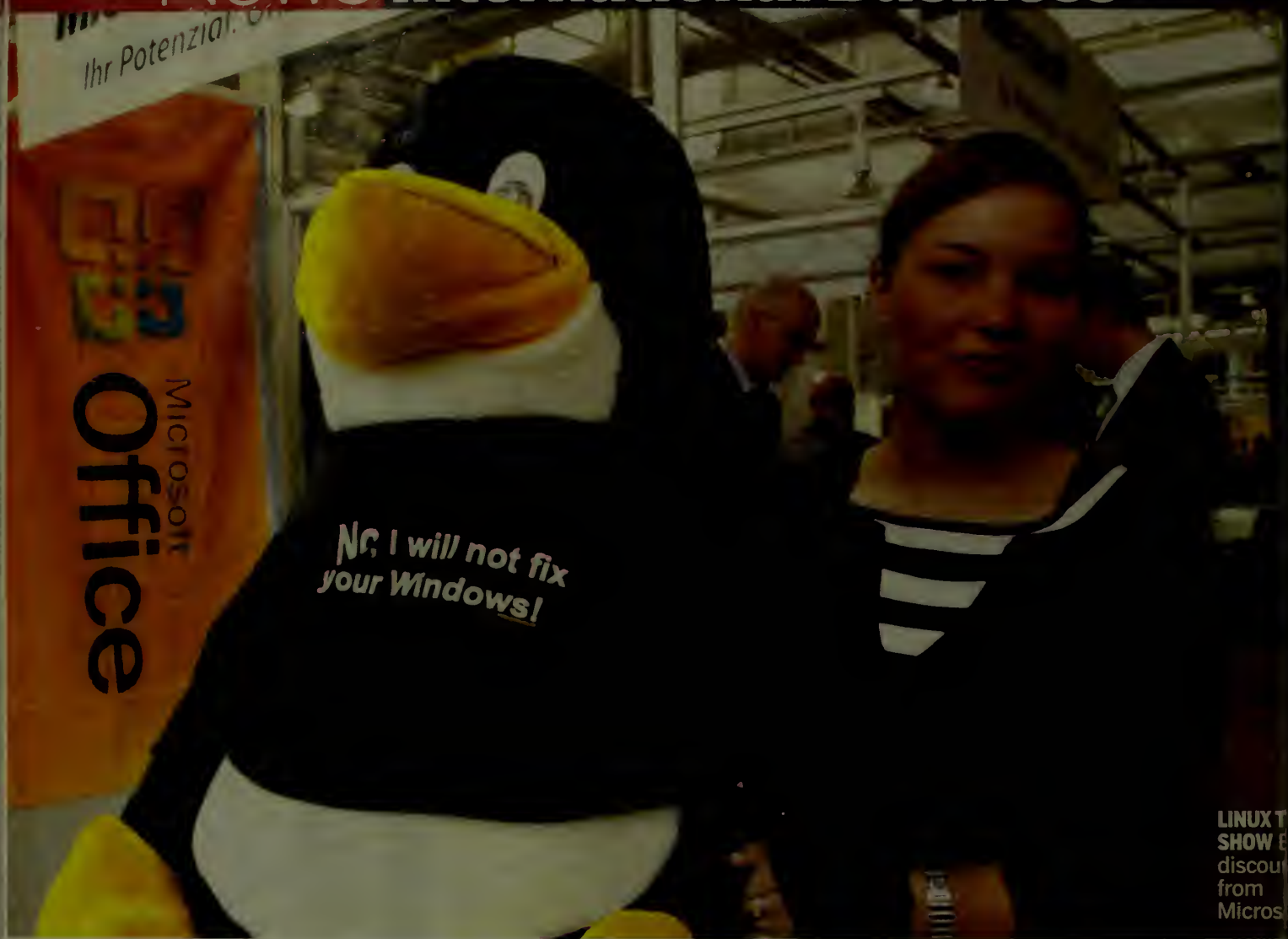
RALPH REED'S NEXT CRUSADE

RALPH REED has gone from the boy wonder of the Christian Coalition to key cog in the turnout machine the Bush campaign hopes will put it over the top on Nov. 2. But even before the votes are counted, Bush's conservative allies have a new calling in mind for Reed: They want him to take over the Republican National Committee next January when Chairman Ed Gillespie's term expires. Some Establishment Republicans are worried that Reed, the ex-Georgia GOP chair, would project too right-wing an image on social issues. If Bush wins, he can appoint anyone he wants to head the RNC. But if Bush loses, a Reed candidacy could provoke a power struggle within the party, with the Old Guard moving quickly to come up with a big-name alternative.

TECH INDUSTRY: KERRY IS GOOD, GOP IS GREAT

REPUBLICANS have been portraying Democrat John Kerry as anti-business, but new ratings by the Information Technology Industry Council give Kerry a lifetime rating of 74% on issues of importance to the tech industry. The ITI Council's High Tech Voting Guide rated Democratic Vice-Presidential candidate John Edwards at 52% for his career. On the Republican side, House Speaker Dennis Hastert scored 90% for his career, and Senate Majority Leader Bill Frist tallied a 96% rating. The most hostile Hill leader: Representative David Obey (D-Wis.) at 29%. Despite Kerry's longtime tech friendships, his 2004 rating plummeted to 0% because he missed all but two votes important to tech.

GEORGE WIDMAN/AP/WIDE WORLD



LINUX SHOW
discour
from Micros

COMPUTING

NOT SO FAST, LINUX

Many European local governments are thinking about ditching Windows, but Microsoft is fighting back

ANTICIPATION BUILT FOR weeks beforehand. The city government of Paris, with 17,000 desktop PCs and hundreds of servers, was mulling a technology shift that would have been unthinkable just a few years ago: retiring Microsoft Corp. Windows software from every one of its machines and converting them to the Linux operating system. So when the results of a feasibility

study were finally announced on Oct. 13, the recommendation to stick with Windows provoked shock and dismay among Linux fans. "I'm totally bummed," wrote one French blogger.

In Europe, software isn't just about bits and bytes anymore. It has become a matter of politics. In city governments from Paris to Vienna to Rome, civil servants and politicians are caught in a fight over competing visions of the future of computing. On one side is Microsoft, which is

trying to hold on to its dominant position in PC and server software. On the other are factions backing the open-source model, which flouts convention by selling software cheaply—or giving it away—and sharing code. The contest playing out in city halls has turned Europe into a key battleground in the global software wars.

It's no wonder open-source is fueling such passion. European governments chafe at Microsoft's market power and want to encourage alternatives. "The

don't like being beholden to a monopoly," says analyst Philip Carnelley of researcher Ovum in London. At the same time, many policymakers see Linux as Europe's best chance to reclaim a role in an industry dominated by American giants. Two of the world's three largest Linux sellers started in Europe.

There's a cultural element, too. Europeans have an affinity for Linux because it was created by a Finn, Linus Torvalds. And the communitarian culture of the open-source movement strikes a chord with the political Left. "There's an attraction to a business model that is closer to utopian socialism," says François Bancilhon, chief executive of Paris-based Linux software maker Mandrakesoft, which sells and supports Linux software.

AN UNDISCLOSED DISCOUNT

SO FAR, MICROSOFT has taken most of the lumps in Europe. Vienna has begun switching over hundreds of its 16,000 PCs to Linux. Norway's second-largest city, Bergen, has decided to convert a score of database servers running the UNIX operating system to Linux, not Windows, and could eventually move 32,000 PCs used in its schools to Linux as well. But the most closely watched case is Munich, which aims to switch 14,000 desktops to Linux by 2008, despite Microsoft's offer of a 35% discount to stick with Windows. The number of such defections clearly caught Microsoft off guard. "Microsoft wasn't prepared for a popular uprising," says Rob Enderle, principal analyst at San Jose (Calif.) consultancy Enderle Group.

Yet over the past 18 months the giant from Redmond, Wash., has unleashed a fierce counterattack, and there are signs that it's working. Paris was only the most recent and important victory. Last January the borough of Newham in London reversed course on a planned change to Linux after a consultant's report said Windows would cost \$600,000 less to support each year. To seal the deal, Microsoft offered Newham an undisclosed discount. The Finnish city of Turku also changed its mind about dumping Windows after a three-year experiment with Linux showed employees resisted the switch. There are reports of glitches and cost overruns from other Linux adopters, including Munich and the German Parliament, which had to revert to Windows servers temporarily in mid-October when a third of its 5,000 PC users couldn't access the Internet or get e-mail. "We're seeing a turning of the tide," says software analyst Tom Berquist of Citigroup's Smith Barney unit in San Francisco.

The comeback is classic Microsoft. After all, this is the same company that missed the rise of the Internet and then went on to crush browser rival Netscape Communications Corp. Microsoft has thrown itself into tackling Linux, hiring dozens of experts in open-source software and offering deep discounts to hold on to clients. It's also sharpening its pitch to address more than just software. "We need to talk in a broader way about investment protection, security, and tying together different kinds of software," says Ashim Pal, Microsoft's European director for platform strategy.

Now, Microsoft hosts booths at Linux trade shows and has set up a Web site

THE REICHSTAG
Linux proved buggy in Berlin



Microsoft vs. Linux

Microsoft has launched an all-out offensive to keep European governments from switching to the rival Linux operating system

PARIS In a closely watched decision, Paris said on Oct. 13 that it will stick with Windows on its 17,000 desktops

BERLIN The German Parliament's Linux migration had to be temporarily reversed in October when technical problems left users without network access

HEIDENHEIM, GERMANY A need to keep running older Windows programs kept the city in Microsoft's camp

NEWHAM, ENGLAND Microsoft persuaded the London borough to reverse a planned switch of 5,000 PCs from Windows to Linux

One obstacle to adopting Linux: The high cost of retraining employees

brimming with customer testimonials and market-research studies poking holes in Linux. Last summer, Microsoft mounted a four-city "Get the Facts" tour of Britain to pitch its story to IT managers. And it took the unprecedented step of inviting 60 government agencies around the world to view the top-secret source code for Windows and so allay concerns about its security and

blunt the advantage of openness enjoyed by Linux. "Transparency increases trust," says Jason Matusow, director of Microsoft's shared-source initiative.

Microsoft's charm offensive isn't all that's vexing Linux. After an initial rush of excitement, governments are weighing more factors. Linux and open-source programs may be cheap, but they can cost plenty to implement. Munich budgeted \$35.7 million for its Linux makeover—\$12 million more than Microsoft's last-ditch offer. While most users insist Linux is cheaper to operate, reports from researchers such as Forrester Research Inc. and Yankee Group assert that the "total cost of ownership"—including upgrades, support, and insurance against potential intellectual-property suits targeting Linux—can be higher than for Windows.

For Paris, the killer was the expense of having to rewrite programs and train thousands of employees on new software. The German city of Heidenheim recently chose not to adopt Linux for similar reasons. "We would have to spend a lot of money to make it happen," says Carsten Urban, head of the city's IT department.

Linux partisans aren't about to surrender. Bancilhon predicts Paris will opt for smaller-scale Linux rollouts in neighborhood offices. Richard Seibt, the European president for U.S. software maker Novell Inc., sees no flagging of interest in Linux among European governments. "What has been announced so far is just the tip of the iceberg," he says, noting that Novell has hundreds of potential government sales of Linux-based products in the pipeline worldwide. All told, figures Gartner Inc., the proportion of PCs sold with Linux installed will climb from 4.4% last year to 5.7% in 2005. A big shift. But it might be a lot bigger if Microsoft weren't turning up the heat. ■

—By Andy Reinhardt, with
Raphael Kahane in Paris and
Gail Edmondson in Frankfurt

UKRAINE

WILL THE BOOM LAST IN UKRAINE?

Investors pray that its tumultuous election won't stifle its superhot economy

IT'S THE FASTEST-GROWING economy in Europe, in the fifth year of a boom that has seen gross domestic product climb by over a third since 1999. This year, GDP is set to expand by an amazing 11% to 13%. Bank lending is growing by more than 50% a year, while the stock market is up 100% in the past 12 months. In the increasingly cosmopolitan capital, the rising prosperity is tangible: from the brand-new shopping complexes in the city center to the luxury apartment buildings under construction on the outskirts. "Now everyone is driving around in foreign cars and having new apartments built. In the last few years the city has come alive," says Slavic Petrenko, a taxi driver. Welcome to Europe's tiger economy: Ukraine.

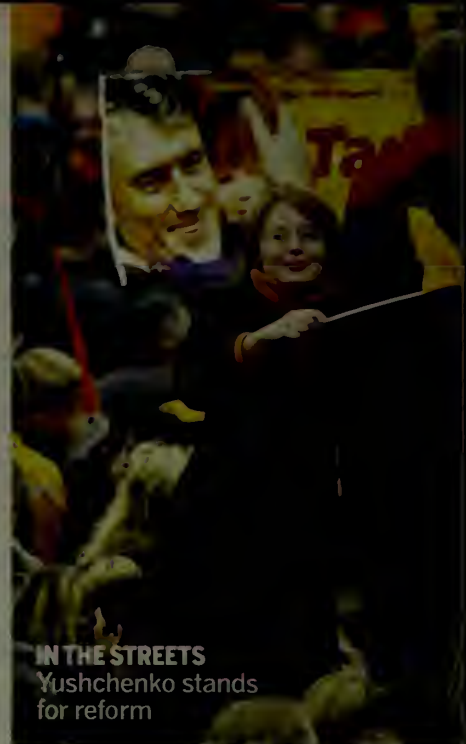
Incredible but true. And the boom is continuing despite one of the wildest political scenes in the former Soviet bloc. Ukraine is holding a presidential election on Oct. 31 to determine the successor of the highly controversial Leonid Kuchma. The race is just as close as the one in the U.S., but even more contentious, with charges of poisoning and a crackdown on the media. Western governments are watching the race closely for fairness, and international organizations are sending 4,000 observers.

The race has international implications.

Russian President Vladimir V. Putin openly backs Prime Minister Viktor Yanukovich, who wants closer ties with Russia. His strongly pro-Western opponent, Viktor Yushchenko, jump-started Ukraine's boom when he was Prime Minister from 1999 to 2001. If Yushchenko wins, Ukraine could see major reforms that'll put it on the global investor map like never before.

NICE WORK

A COMBINATION of good luck and good macroeconomic policy is behind Ukraine's boom. The luck is that metals, particularly steel, make up 60% of Ukraine's exports. Global prices have been high, thanks largely to demand from China and other Asian markets. There's a risk that a big fall in metals prices might unhinge growth. But the risk is mitigated by the healthy macroeconomic picture and rapid growth in noncommodity sectors. The country has a 9.7% current account surplus, public debt is a low 24% of GDP, and inflation is in single digits. The wide-ranging privatization of the 1990s is bearing fruit: Some two-thirds of GDP is produced by the private sector, the main engine of growth. True, much of that is owned by a handful of tycoons. But these oligarchs are investing serious money in sectors such as agri-

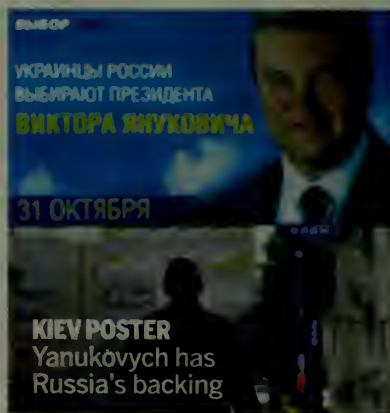


culture, telecom, and banking. "Yes, privatization was dirty, but it has shown its effectiveness," says Olexander Pashkevych, president of the Center for Economic Development in Kiev.

The bigger question is whether Ukraine can achieve the political stability needed to keep growth and investment on track. What's really needed are big manufacturers, and they're starting to come. Last year automotive suppliers Lear from Germany and Yazaki Corp. from Japan opened plants in western Ukraine, investing \$50 million and \$40 million respectively. Singapore electronics giant Flextronics Corp. plans a \$50 million auto electronics plant. Ukraine also is developing a brisk export market in software. Flextronics and the others are drawn by labor costs below \$160 a month per worker, including taxes and social levies, vs. about \$400 a month in Poland.

Western investors in Ukraine prefer Yushchenko, but they could live with Yanukovich, provided his election is aboveboard. The one outcome that could freak out investors is if authorities manipulate the count or resort to even more drastic means to keep the opposition from power. The government swears the election will be fair. But as polling day approaches, the situation is growing tense, with rumors of army units being deployed around the capital. Which is it to be—a civil war or a continued boom? That's a question voters in the 2004 U.S. presidential race don't have to worry about. ■

—By Jason Bush, with Roman Olearchyk in Kiev





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TOKYO DEBUT
Eight new Sony models

JAPAN

SONY'S PICTURE LOOKS BRIGHTER

Its electronics unit is back on its feet, but the real test comes at Christmas

IT WAS ONCE THE CROWN JEWEL of the Sony empire. But for years now the Japanese company's consumer-electronics division—responsible for everything from TVs to Walkmans to DVD players—has been a disaster. Since the halcyon days of the late '90s, when the division was the profit leader for the company, Sony Corp. has seen its electronics unit fall deep into the red, losing \$300 million in the 12 months ended March, 2004.

Finally, though, Sony is showing results. In the quarter ended in June, the electronics division reported a profit of \$65 million. Earnings for the September quarter, scheduled to be announced on Oct. 28, were expected to confirm the trend. Brokerage Merrill Lynch & Co. predicts the electronics business will book sales of \$45.4 billion and profits of \$375 million this fiscal

year. Not a bad recovery, although it pales next to the \$2.3 billion the division earned in 2000 and remains well below the combined \$1 billion Merrill expects Sony's far-smaller games, music, and movie units to earn this year.

Much of the turnaround stems from painful rethinking of the way Sony does business. By 2006 it expects to trim \$2.8 billion in annual costs from the electronics division, mostly through layoffs and early retirements. And Sony is cutting its parts list. One example is the number of

chassis—or basic platforms—used in its TV sets: A year ago, there were 30, today there are 15, and the target is six by 2006. "When we use common chassis, production gets much easier, so our production costs drop" by 30% or more, says Makoto Kogure, head of the TV unit.

But Sony insists this isn't simply a cost-cutting story. Instead, the

company is trying for greater vertical integration, buying the bulk of key parts for its most profitable products from inside the company rather than from outsiders. This technique has been tried off and on by many companies over the years, but Sony sees it as a big new strategic advantage. Sony's camera division, for instance, a year ago bought just 30% of the parts for

its still cameras from other company units. But the ultraslim T1, introduced this year, is 60% Sony-made.

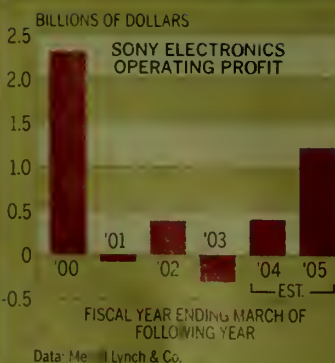
That's not to say all of Sony's problems are behind it. Facing strong challenges from the likes of Samsung, Sharp, and a host of Chinese upstarts, Sony is in the red on LCD and plasma TVs, and its margins fall in DVD players and traditional TVs, according to brokerage Deutsche Bank Securities Inc. Sony "is losing money in its star products, and the margins on its older products are declining too quickly," says Deutsche Bank analyst Yasuo Nakane.

Sony, though, says it has a slew of hits up its sleeve that will put it back on top. This year, executives say, they will raise research and development spending in electronics by 33%, to \$1.9 billion. That money is being spent on high-definition TVs with screens the size of Texas, such as the Qualia 006, a 70-inch rear-projection model that will cost around \$10,000 when it debuts in the U.S. in time for next year's Super Bowl.

Will the new products be enough to boost Sony's electronics profits? Reviewers are generally impressed, and analysts say the vertical-integration scheme makes sense. The verdict will be seen in Christmas sales, says Merrill Lynch analyst Hitoshi Kuriyama. "If their new products are a hit, investors and consumers will believe in Sony again," he says. "If not, it will look like a no-growth company" and may never get back to the fat margins of the 1990s. For its part, Sony is downplaying the importance of Christmas—as long as its new products get noticed. "This year my target is to show the kind of quality we're aiming for," says Kogure. "Next year we will pursue quantity." Coming from behind? That used to be someone else's problem, not Sony's. ■

—By David Rocks in Tokyo

PROFIT PROBLEM





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— Debra Jorgensen,
Merrill Lynch Financial Advisor

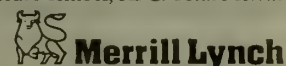


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COMMENTARY

BY GERI SMITH

How China Opened My Eyes

An old Mexico hand tours China and is impressed at the nation's fierce drive

AS I WALKED through the brand-new, \$2.4 billion international airport in Guangzhou, China, I marveled at the soaring stainless-steel beams, the four-story, palm-filled atrium, and the state-of-the-art technology. Inaugurated in August, the airport can handle 27 million passengers a year and 1 million tons of cargo from the Pearl River Delta's thousands of export factories.

Just days earlier, as I departed from Mexico City's 50-year-old airport, I prayed that rain wouldn't shut down the two puddle-prone runways. Two years ago, President Vicente Fox set out to build a new airport, but machete-wielding peasants whose land was to be expropriated scuttled the project. Instead of insisting on the importance of a modern gateway to a \$627 billion economy, Fox caved in. Today the airport is undergoing a \$430 million facelift that merely postpones the capacity crunch, because there's no space to build additional runways.

As *BusinessWeek's* Mexico City bureau chief, I have chronicled how China has siphoned precious investment and jobs from Mexico. But it wasn't until September, when I got a fellowship to travel through China for two weeks, that I saw with my own eyes what Mexico is up against.

The trip was fascinating—and sobering. Fascinating because China is developing at a pace that is remarkable to behold. Sobering because it drove home to me how stagnant Mexico looks in comparison. I knew China had the edge over Mexico in cheaper labor and lower taxes. But China's real advantage lies in the whole package it offers investors: impressive infrastructure, able managers, an enthusiastic workforce, and—above all—spirit.

What do I mean by spirit? The sense the Chinese have that anything is possible. Case in point: At a Motorola Inc. facility we visited in Chengdu, dozens of software engineers gathered for a lecture on *The Seven Habits of Highly Effective People*. A bit corny? Sure. But the engineers were listening raptly, determined to learn how they might earn the performance-linked stock options their plant manager dangled before them.

What else sets China apart? On the streets, I was approached by young people eager to practice the English they had learned in school: In 2002, China made English classes mandatory starting in grade school. In Mexico, English is still optional,



even though the country is next door to the world's biggest English-speaking nation. Efraín Payán, a Mexican businessman who also visited China in September on a trade mission was floored by the Spanish-speaking translators the government provided. "Their Spanish was perfect," he marveled. "They have really worked hard to get where they are."

The Chinese certainly have a long way to go. Democracy is nonexistent. Pollution is dire. Joblessness is a big problem. But its drive and enthusiasm still give China an edge over Mexico. In an A.T. Kearney Inc. study of the world's most attractive destinations for investment, released on Oct. 12, Mexico

fell to 22nd place, down from No. 3 the previous year. China, meanwhile, has ranked No. 1 for three years. "Unfulfilled reforms in key areas such as telecom, infrastructure, and energy—and the magnetic pull of China—have led global investors to rethink Mexico," wrote the authors. "In Mexico if you ask anyone where Mexico is going in the next three to five years, no one knows," says Carl Rianhard, president of OpenTec, a Mexican developer of Web-based e-learning applications, who has visited China several times.

What should Mexico do? Invest in better education. Build more highways. Open the energy sector to private investment. Enact real tax reform to pay for all of the above. That's the standard prescription. But how about this proposal: All Mexicans in a position of leadership—in business, education, or government—should buy a plane ticket to China now and see for themselves what Mexico is up against. They can fly to one of a dozen major airports China has built in the past decade (vs. one for Mexico), travel along 17,800 miles of highways (Mexico has added just 1,670 miles in 10 years), roam the bustling shopping districts, and see how a giant is reawakening. Then they should fly home and start the serious business of reawakening Mexico. ■

Mexico can't even get a new airport built to serve its capital city

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EDITED BY ROSE BRADY

Can Assad Halt Syria's Diplomatic Slide?

SYRIA'S YOUNG PRESIDENT, BASHAR AL-ASSAD, has been sailing along oblivious to the dangers his government has been courting. Now he's waking up fast. In September the U.N. Security Council passed a humiliating resolution calling for Syria to withdraw its 20,000 troops from Lebanon, which it has occupied since

the civil war there in the 1970s. The move took Syria by surprise. Particularly alarming was the role of France, Syria's key Western backer, in co-sponsoring the resolution with the U.S. The Syrians were "completely flabbergasted" by France's position, says Rime Allaf, a Syrian specialist at London's Chatham House.

Assad got the message: Syria's standing has fallen dangerously low. Even the country's presence in Lebanon, which the international community has long tolerated, is open to challenge. Thanks to shrewd maneuvering by Bashar's father, Hafez, who died in 2000, Syria had long enjoyed outsize clout in the region, but that influence may be ebbing under his 39-year-old son. The question is how Assad will deal with that situation. He could become more malleable in any peace talks with Israel or in cooperating with the U.S.-installed regime in Iraq. But he could be tempted into rash moves such as jacking up tensions in the region.

Border crackdown

FOR NOW, THE U.N. rebuff has spurred Assad to take charge of foreign policy. He has redeployed 3,000 troops from Lebanon and persuaded representatives of Palestinian militant groups in Damascus to make themselves scarce. The Syrian military is making a show of cracking down on unauthorized traffic across the Iraqi border—including the flow of suspected insurgents—that has angered the U.S. And Assad is hinting he wants to resume peace talks with Israel.

The British-trained ophthalmologist is also taking small steps to modernize the economy. He has licensed several Lebanese

and Arab banks to set up shop in Syria, which has no real bank system. And he has championed the spread of computers and mobile phones. Business welcomes the moves, but more is needed. Living standards are eroding as the state-controlled economy fails to keep up with population growth. Per capita gross domestic product is about \$1,100.

Assad hopes to replace his father's advisers and policies. But he may not have much leeway to alter Arab nationalist policies, and the power structure could take years to overhaul. "Unlike [Hafez], he is not seen as the law of the land," says Murhaf Jouejati, a Syrian political science professor at George Washington University.

Assad has demonstrated little of his father's political flair. After Saddam Hussein's fall in 2003, for example, Syria's halfhearted attempts to secure its borders with Iraq left the country open to charges that it backed insurgents fighting the U.S. The contrast with the elder Assad's decision to

join the coalition that defeated Saddam in 1991 couldn't be starker. The younger Assad also failed to appreciate that hosting militant Palestinian groups was no longer smart. The Israelis recently assassinated a Palestinian militant in Damascus.

These setbacks may be teaching Assad a valuable lesson. "He is becoming more involved to make sure Syria makes smart decisions," says Theodore H. Kattouf, U.S. Ambassador to Syria from 2001-03. But if Bashar doesn't greatly improve his game, a country used to punching above its weight may become marginalized. ■

—By Stanley Reed in London



BAD MOVES Assad has shown little of his father's political flair

GLOBAL WRAPUP

A WIN FOR THE EU'S PARLIAMENT

IT MAY MARK a turning point for the usually weak European Parliament. Faced with the threat of a first-ever parliamentary veto of a proposed new European Commission, EC President **José Manuel Barroso** withdrew his slate of 24 candidates on Oct. 2 and asked for more time to propose a new team. The decision, which prevents Barroso from taking office on Nov. 1, is seen as a victory for the Parliament. The 732-member body has only limited powers and has failed to wield them effectively in the past.

This time the Parliament objected to several commission nominees, including Italian Justice Commission candidate **Rocco Buttiglione**, who in a public hearing called homosexuality a sin. Now, Barroso must reshuffle the portfolios or seek new national candidates that can pass muster before a scheduled vote on the commission in mid-November.

VIOLENCE MAY BEGET VIOLENCE IN THAILAND

NEARLY 80 PEOPLE died of suffocation while in police custody in southern Thailand after being trucked away from the scene of a violent demonstration on Oct. 25. More than 430 have died in the Muslim-dominated south this year as separatists and Islamic radicals have clashed with officials. The heavyhanded police treatment is likely to inflame Muslim resentment against the government. That doesn't augur well for **Prime Minister Thaksin Shinawatra**, who is seeking reelection in polls due by February. Thaksin blamed the deaths on the victims, whom he says were weak from Ramadan fasting.



FULL PLATE Brenneman hopes to cap his turnaround with an IPO in '06

built a reputation as a turnaround wizard at Bain & Co. and then at his own firm, TurnWorks Inc. After helping TPG-backed Continental Airlines return to profitability in the 1990s, he engineered the 2002 sale of PricewaterhouseCoopers to IBM for \$3.5 billion. A triumph at Burger King would surely shoot him to the top of the A-list for CEO gigs at larger companies.

Still, developing a recipe to stop Burger King's decline will be Brenneman's biggest challenge yet. The chain had been a proud No. 2 to McDonald's Corp. for 50 years, winning over burger fans with its signature

flame-broiled Whoppers and made-to-order meals. It faltered under Diageo, which was more focused on promoting Guinness beer, Smirnoff vodka, and its other booze brands. TPG, along with two other investors, picked up Burger King for \$1.5 billion—a steal, considering the original asking price was \$2.6 billion. But the chain is on the verge of being overtaken by Wendy's, and many industry watchers worry Brenneman won't be able to fend off the attack. "The odds are against him, given the quality of the competition," says David S. Palmer, restaurant analyst at UBS Securities Inc.

ENORMOUS OMELETTE

BRENNEMAN HASN'T had time to pay much heed to the naysayers. In his first 90 days, he developed a lofty turnaround plan that he hopes to cap with a public offering of Burger King shares in 2006. The chain had already introduced low-calorie salads and a veggie burger. But to ratchet up breakfast sales, Brenneman sent his menu crew off to develop the Enormous Omelette Sandwich—an artery-clogging four-layer concoction of egg, sausage, and cheese—which will make its debut next year. He plans to buy back some stores from franchisees to give the parent greater control over menus and store design. And he figured out how to lower startup costs from \$1 million to \$600,000 for each new store. Many of the 1,200 franchisees are optimistic. "This is real, not Memorex," says Alvaro M. Cab-

Fat's in the Fire for This Burger King

CEO Brenneman has to find the recipe for stopping the chain's decline

ON A MID-SEPTEMBER day, Burger King Corp.'s new CEO, Gregory D. Brenneman, rode into the parking lot of the company's Miami headquarters in a convertible wearing a costume and giant mask of the King, the fast-food chain's mascot. As 700 employees cheered, Brenneman presided over a ceremony in which all corporate staff members were handed bonus checks worth three times more than what they got last year.

Never mind that Burger King's sales and profits have been languishing for much of the past two years. Brenneman felt the generous bonuses would boost the morale of the workers he's counting on to turn around the ailing company. "We

want to get healthy," Brenneman says.

It's going to take a whopper of an intervention to fix the nation's second-largest burger chain. From 2000 to 2002, when Burger King was still owned by the British liquor maker Diageo PLC, the chain's profits dropped 21%, to \$288 million. Burger King's hamburger market share fell from 18.5% in 2001 to 15.6% last year, estimates Technomic Inc., a Chicago restaurant research firm. Even after buyout firm Texas Pacific Group (TPG) scooped up Burger King and took it private in December, 2002, sales and profits continued to fall, analysts believe, as a stale menu and dirty restaurants drove fast-food lovers away.

Now TPG is counting on Brenneman, 42, to get the King back on its feet. Named CEO in July, the former consultant had



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People Turnarounds

ra, who owns 178 outlets in six states.

Brenneman's Burger King game plan is, in part, a reprise. In 1994, after Continental had emerged from its second bankruptcy, CEO Gordon Bethune chose Brenneman, then a consultant at Bain, to become the airline's chief operating officer. Brenneman had already proven his mettle by advising Continental to cut \$283 million in maintenance costs. A year later he was named president, and his eye for efficiency sharpened. When Continental's scheduling team confessed that six daily commuter flights had never

team sport," he says. Each Friday, broadcasts folksy voice mails about the chain's fortunes to employees and franchisees. He isn't afraid to play tough though: In September, after hearing nasty e-mails flying between feuding execs, he told perpetrators to cut it out or they would be fired.

Born into a Mennonite family in Newton, Kan., Brenneman developed an early appreciation for hard work. As a teenager he manicured a golf course in the morning, delivered furniture in the afternoon and chucked hay on his grandfather's

BIO BOX

Gregory D. Brenneman

The former Bain & Co. consultant has built a reputation as a turnaround wiz:

BORN Nov. 26, 1961, in Newton, Kan.

EDUCATION BA, Business, Washburn University, 1984; MBA, Harvard Business School, 1988.

CURRENT POSITION Chief Executive Officer, Burger King Corp.

CAREER PATH Worked at Bain & Co. in the early 1990s. Became COO of Continental Airlines in 1994 and president in 1995. Founded consultancy TurnWorks Inc. in 2001.



OFFBEAT
Burger King's TV ads got quirkier

There he engineered several deals, including the 2002 sale of PwC Consulting to IBM. Joined Burger King as CEO in July, 2004.

FIRST JOB Baling hay on grandpa's farm in Hesston, Kan.

HOBBIES Snowshoeing, skiing, marathon running.

FAVORITE FAST FOOD Then: Popeye's fried chicken. Now: Burger King's Angus Steak Burger.

FAMILY He and wife, Ronda, have three children.

made money, Brenneman jokingly asked if those routes existed because executives' boyfriends or girlfriends needed to fly them. The routes were quickly eliminated. By 1995, Continental had turned a profit.

FROZEN OUT

A BRUISING DISPUTE with his then-boss ended Brenneman's run at Continental in 2001. That year, rumors started flying that Brenneman and Continental's chairman of the board, TPG founding partner David Bonderman, were trying to orchestrate Bethune's ouster. People close to the matter confirm that Bonderman had discussed the top job with Brenneman. After word leaked back to Bethune, he froze out Brenneman, driving the executive to look for other jobs, says a Continental director.

Bonderman later installed Brenneman at Burger King. Singed by his Continental experience, Brenneman concluded that the key to fostering teamwork is open and honest communication. "Business is a

wheat farm until dark. He had a penchant for mischief, too: He and a group of friends once disassembled a playground jungle gym late at night, lowered through the skylight of the local middle school, and reassembled it on the gymnasium floor. School officials were stumped by the caper.

Burger King can appreciate that cheeky attitude. The chain's latest offbeat ad features the King in bed with a man, sharing a breakfast sandwich. On a company Website, SubservientChicken.com, visitors instruct a lingerie-clad chicken to do pushups and other tricks. Burger King even resurrected its 1970s slogan, "Have It Your Way." If Brenneman pulls off this turnaround, when it comes to his next career move, he may indeed have it his way. ■

—By Brian Grow in Miami

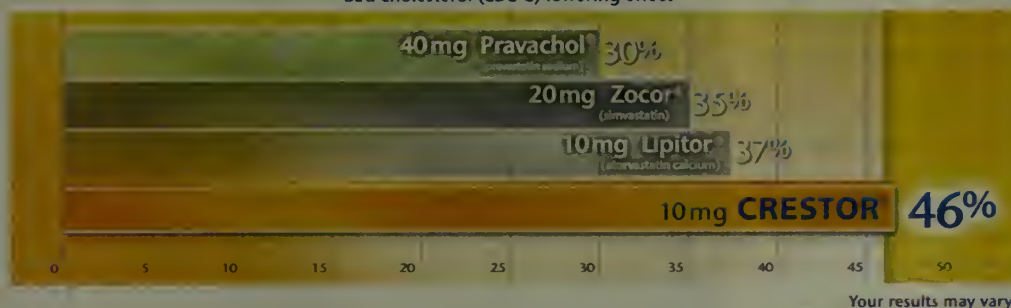
BusinessWeek online For more on Burger King's turnaround strategy, go to businessweek.com/magazine/extra.htm

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Important information: CRESTOR is prescribed along with diet for lowering cholesterol and is not for everyone, including people with liver disease, and women who are nursing, pregnant, or may become pregnant. Tell your doctor promptly if you experience unexplained muscle pain or weakness, as they may be a sign of serious side effects. Be sure to tell your doctor about other medications you are taking. Simple blood tests are needed to check for liver problems before and 12 weeks after start of therapy or change of dose, and periodically thereafter. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away. CRESTOR has not been shown to prevent heart disease or heart attacks. See adjacent page for additional important information.

*Source: Most commonly prescribed doses based on IMS (August 2003-July 2004).

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BRIEF SUMMARY: For full prescribing information, see package insert.

INDICATIONS AND USAGE CRESTOR is indicated as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, non-HDL-C and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable.

CONTRAINDICATIONS CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes).

Pregnancy and Lactation Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILDBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus.

WARNINGS **Liver Enzymes** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN]) occurring on 2 or more consecutive occasions) in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter. Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS).

Myopathy/Rhabdomyolysis Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses of up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. Rare cases of rhabdomyolysis were seen with higher than recommended doses (80 mg) of rosuvastatin in clinical trials. Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. The incidence of myopathy increased at doses of rosuvastatin above the recommended dosage range. Consequently 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine. (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and OOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (See DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 4. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 5. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures).

PRECAUTIONS **General** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment ($CL_{CR} < 30 \text{ mL/min/1.73 m}^2$) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and OOSAGE AND ADMINISTRATION). Pharmacokinetic studies show an approximate 2-fold elevation in median exposure in Japanese subjects residing in Japan and in Chinese subjects residing in Singapore compared with Caucasians residing in North America and Europe. The contribution of environmental and genetic factors to the difference observed has not been determined. However, these increases should be considered when making rosuvastatin dosing decisions for patients of Japanese and Chinese ancestry. (See WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race).

Information for Patients Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine analysis.

Drug Interactions **Cyclosporine** When rosuvastatin 10 mg was coadministered with cyclosporine in renal transplant patients, rosuvastatin mean C_{max} and mean AUC were increased approximately 2.5-fold and 3.5-fold, respectively, compared with healthy volunteers. These increases are considered clinically significant and require special consid-

eration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis, and DOSAGE AND ADMINISTRATION). **Warfarin** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumatin anti-coagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been determined, INR can be monitored at the intervals usually recommended for patients on coumatin anti-coagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anti-coagulants. **Gemfibrozil** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean C_{max} and mean AUC of rosuvastatin (see OOSAGE AND ADMINISTRATION).

Endocrine Function Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketoconazole, spiroglactone, and cimetidine. **CNS Toxicity** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallenian degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the

human exposure at 40 mg/day based on AUC). Doses <30 mg/kg/day (systemic exposures <50 times the human exposure at 40 mg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at 80 mg/kg/day at systemic exposure 20 times the human exposure at 40 mg/day based on AUC. Increased incidence of polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* mouse micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 30 mg/kg/day for one month, spermatid giant cells were seen. Spermatid giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolation of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class.

Pregnancy **Pregnancy Category X** See CONTRAINDICATIONS. Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg/kg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose of 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised of the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 post-coitus results in decreased fetal body weight (female pups) and delayed ossification at the high dose (systemic exposures 10 times human exposure at 40 mg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning), decreased pup survival occurred in groups given 50 mg/kg/day, systemic exposures >12 times human exposure at 40 mg/day based on body surface area comparisons. In pregnant rabbits given oral gavage doses of 0.3, 1, 3 mg/kg/day from gestation day 6 to lactation day 18 (weaning), exposures equivalent to human exposure at 40 mg/day based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at <25 mg/kg/day or in rabbits <3 mg/kg/day (systemic exposures equivalent to human exposure at 40 mg/day based on AUC or body surface comparison, respectively).

Nursing Mothers It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk at levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin taking into account the importance of the drug to the lactating woman.

Pediatric Use The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in the pediatric population is limited to 8 patients with homozygous FH. None of these patients was below 8 years of age. **Geriatric Use** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency of adverse events and

types of adverse events were similar in patients above and below 65 years of age. (See WARNINGS, Myopathy/Rhabdomyolysis.) The efficacy of rosuvastatin in the geriatric population (>65 years of age) was comparable to the efficacy observed in the non-elderly population.

ADVERSE REACTIONS Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies of 10,275 patients, 3.7% were discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences** Adverse experiences, regardless of causality assessment, reported in >2% of patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1; discontinuations due to adverse events in these studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% in placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

Adverse event	Rosuvastatin N=744	Placebo N=382
Pharyngitis	9.0	7.6
Headache	5.5	5.0
Diarrhea	3.4	2.9
Dyspepsia	3.4	3.1
Nausea	3.4	3.1
Myalgia	2.8	1.3
Asthenia	2.7	2.6
Back pain	2.6	2.4
Flu syndrome	2.3	1.6
Urinary tract infection	2.3	1.6
Rhinitis	2.2	2.1
Sinusitis	2.0	1.8

In addition, the following adverse events were reported, regardless of causality assessment, in >1% of 10,275 patients treated with rosuvastatin in clinical studies. The events listed occurred in >2% of these patients. **Body as a Whole:** Abdominal pain, accidental injury, chest pain, infection, pain, pelvic pain, and neck pain. **Cardiovascular System:** Hypertension, angina pectoris, vasodilatation, and palpitation. **Digestive System:** Constipation, gastroenteritis, vomiting, flatulence, peridontal abscess, anorexia, gastritis. **Endocrine:** Diabetes mellitus. **Hemic and Lymphatic System:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** Peripheral edema. **Musculoskeletal System:** Arthritis, arthralgia, and pathological fracture. **Nervous System:** Dizziness, insomnia, hypertonia, paresthesia, depression, anxiety, vertigo, and neuralgia. **Respiratory System:** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Skin and Appendages:** Rash and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function (see PRECAUTIONS, Laboratory Tests). Other abnormal laboratory values reported were elevated creatinine phosphokinase, transaminases, hyperglycemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and thyroid function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, hypersensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous rash, urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, photosensitivity reaction, myopathy, and rhabdomyolysis.

OVERDOSEAGE There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION** The patient should be placed on a standard cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during treatment. CRESTOR can be administered as a single dose at any time of day, with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial) and Mixed Dyslipidemia (Fredrickson Type IIa and IIb)** The dose range for CRESTOR is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to goal of therapy and response. The usual recommended starting dose of CRESTOR is 10 mg once daily. Initiation of therapy with 5 mg once daily may be considered for patients requiring less aggressive LDL-C reductions or who have predisposing factors for myopathy (see WARNINGS, Myopathy/Rhabdomyolysis). For patients with marked hypercholesterolemia (LDL-C > 190 mg/dL) and aggressive lipid targets, a 20-mg starting dose may be considered. The 40-mg dose of CRESTOR should be reserved for those patients who have not achieved goal LDL-C at 20 mg (see WARNINGS, Myopathy/Rhabdomyolysis). After initiation and/or upon titration of CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted accordingly. **Homozygous Familial Hypercholesterolemia** The recommended starting dose of CRESTOR is 20 mg once daily in patients with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. Response to therapy should be estimated from pre-apheresis LDL-C levels. **Dosage in Patients Taking Cyclosporine** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis and PRECAUTIONS, Drug Interactions). **Concomitant Lipid-Lowering Therapy** The effect of CRESTOR on LDL-C and total-C may be enhanced when used in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency** No modification of dosage is necessary for patients with mild to moderate renal insufficiency. For patients with severe renal impairment ($CL_{CR} < 30 \text{ mL/min/1.73 m}^2$) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and not to exceed 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

NOTE: This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information and discuss it with them.

Rx only

Reference: IMS National Prescription Audit (August 2004)

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Plain Talk from Larry Summers

Harvard's president surveys the outlook for the U.S. economy and the university



ON THE ECONOMY
"We're going to be on fairly thin ice"

FORMER TREASURY SECRETARY Lawrence Summers, now the 27th president of Harvard University, became a tenured professor of economics there at age 28. He has since divided his career between academia and Washington. On Oct. 21, as part of the Captains of Industry series at New York's 92nd Street Y, Summers and *BusinessWeek* Editor-in-Chief Stephen B. Shepard had a wide-ranging discussion. Some excerpts:

What was so attractive about Washington that you spent so many years there?

The most difficult day of my professional life was the day in 1993 when I wrote a letter resigning my tenure at Harvard. But I really became caught up in what I was

doing, first at the World Bank, and then in the Clinton Treasury. I don't think we got everything right, but I believe that because of decisions President Clinton made, that were unpopular when he made them—to reduce the U.S. budget

deficit substantially—millions of workers earned higher incomes going forward.

You were there during one of the great booms, yet underneath we now know there were problems. Did you have any inkling of trouble during that period?

Sure we did. In almost every speech for about a year and a half, I would say: "The main thing we have to fear is the lack of fear itself." Optimism can be a self-denying prophecy if it leads to unsustainable spending plans or excessive expansion of credit or unrealistic growth in capacity. So yes, there was an awareness of where the risks were.

Do you share Greenspan's view that even if you think there is a bubble, there is really nothing you can do about it?

There is not much you can do. I think we tried to say cautionary things...with some frequency. I don't think it's responsible for public officials to make hubristic forecasts. And in terms of one of the important indicators, public policy has gotten less credit than it has deserved. The bank regulators at the Comptroller of the Currency, which was part of the Treasury, and the Federal Reserve, did warn the banks about the dangers of boom-time lending. And while the last four years in this country haven't been easy, what is striking is how little distress there has been in the banking system. One of the reasons for that is that public policy promoted a diverse system of finance with multiple sources.

Sure, people invested in vastly more fiber-optic cable than made any sense, but the government [shouldn't] make judgments about what the appropriate level of investments in different industries is.

We had an era when unemployment fell to 3.9%. We had very strong growth, no inflation, budget surpluses. Is this a replicable thing, or did we get lucky?

Vince Lombardi had it right when he said: "You make your breaks." Clearly, we were lucky in the 1990s [with] growth and productivity, in what high tech was able to accomplish. But one of the main reasons people were willing to take the long view was that there were low costs of capital, [partly because] the government was eliminating pressure on credit markets. We benefited enormously from information technology, but that was [partly because] the government for years had invested in the formation of networks.

Could it ever happen again?

The underlying rate of technical progress

and productivity growth—what economists call total factor productivity growth—has accelerated in the last four years. So there is at least a prospect of rapid growth. I'm guardedly optimistic for the medium to long term in terms of the economy's potential. [But] the policies that have led to a resumption of substantial budget deficits, low national savings, and huge dependence on foreign capital mean we're going to be on fairly thin ice for the next several years.

Why are we having such a hard time creating jobs now, despite decent growth?

If you have more rapid productivity growth—at 3%—and the economy grows at 3%, you need the same number of people working as you did before. So it's a high-class problem to have. It means you get the same amount of output with less work, but it does mean you need to find ways of assuring the confidence in the future that will enable businesses and individuals to spend. That's why the magnitude of the future tax cuts that attenuate our flexibility to respond is unfortunate.

How serious a problem is outsourcing to India and China?

It's sort of like asking how serious a problem is the winter in New York. We can't place a variety of restrictions on where businesses choose to produce and not do enormous damage to the efficiency and effectiveness of our economy.

In a progressive economy, technology can do things people used to do, and people are going to lose jobs. That's a larger phenomenon and a larger issue than what happens with outsourcing. We have to think about the needs of those people. We can provide income support and a systematic way to retrain. I'm all for a dynamic global economy, but at the same time we have to look out for people here.

Have your views about globalization changed? Even your uncle, the economist Paul Samuelson, seems to have some reservations about the global system.

If you try to block progress and try to restrict the ability of businesses to locate where they want to, or try to restrict the flow of imports, you will make the vast majority of people poorer. I prefer recognizing that the rise of India and China is much like the rise of new technologies—new productive opportunities for the U.S. economy. You have to work with those

new opportunities and make sure people aren't left behind.

I live in Boston and New England. Boston is one of the most prosperous areas of the country, supported by institutions like mine at Harvard, by vibrant financial services. It has a terrific biotech and health-care industry and some other technology. Thirty years ago, New England was dependent on shoes and textiles, and those jobs moved away. Some thought the right strategy was to try to stop those jobs moving away. I have no doubt that people



"I'm all for a...global economy, but ...we have to look out for people here"

in New England today have better job opportunities because we allowed for changes in the economy.

Let's talk about Harvard. What do you want to change in undergraduate education, and how much progress are you making?

Two issues go to the content of what we teach undergraduates. Our country

has never so misunderstood the world and has never been so misunderstood in the world. So we will create an expectation that all students will have an international experience in college.

You can say something similar about science. It's a crucial issue in the traditions of our universities. There is an idea that if a person doesn't know the name of five plays by Shakespeare, they would be embarrassed. But if you don't know the difference between a gene or a chromosome, well, that's a technical subject others can worry about. In a world where disease cures depend on stem cells, where computers are a pervasive part of life, I don't think that's good enough.

A third element is making sure there is the right kind and enough

contact between students and faculty.

Do you have any other priorities?

I would highlight equal access in higher education. Inequality between those in the high-income groups and those in the low income groups is widening. In the last two decades, for the first time probably in the country's history, the gap in life prospects...is growing. One of the reasons is that the gap in the college enrollment rate between [those groups] is growing.

We announced last year that any student with a family income under \$40,000 can come to Harvard with no parental contribution at all. That has had a substantial influence on the flow of our applications and on our student body.

Need-blind financial aid shouldn't just be in a college. What if you want to come to the Harvard Graduate School of Education to be a teacher, or the Harvard Medical School to work in a clinic, or the Harvard Public Health School to work in Africa on AIDS? So we increase the financial aid and

the loan forgiveness for people going into some form of service to society.

Talk about the Harvard endowment. There was a little controversy about the compensation of those who manage it.

They have a disciplined approach based on a substantial amount of diversification. So they are invested in timber, commodities, real estate, and less than a fifth in domestic U.S. stocks.

We've had some issues because we, unlike almost every other university, employ some of our own portfolio managers. Most universities hire hedge funds [which] pay huge salaries to their best traders. We hire our own traders and therefore pay them huge salaries, and people sometimes get upset.

The easy thing would be to say we weren't going to do it anymore and hire external managers, like everybody else does. [But] we would then be spending \$50 to \$100 million a year more getting our endowment managed. It would be easier to do the inefficient thing and avoid bad publicity, but I don't think it would be the right thing to do. ■

BusinessWeek online For a video of the conversation with Lawrence Summers, go to www.businessweek.com/magazine/extra.htm

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COMMENTARY

BY JESSI HEMPEL

When Charity Begins at Home

With the IRS focused on corporations, abuse among foundations is spreading

JAMES BEARD Foundation President Leonard F. Pickell Jr. resigned under a cloud in September after board members discovered that the New York culinary group had squandered hundreds of thousands of dollars. Sure, that's pocket change compared with many corporate scandals, but the missing money—allegedly frittered

away on hefty salaries and extravagant meals—is a big chunk of the nonprofit's \$4.7 million annual revenue.

It also includes taxpayer dollars, since the organization is tax-exempt. Now, as the New York State attorney general investigates, board members are moving to overhaul the foundation's governance. "We have to restore the public's trust," concedes Beard Chairman George P. Sape.

When scandal hit Corporate America several years ago, the Internal Revenue Service shifted resources into corporate tax audits. Of course, the move made sense, but a little-known consequence is that it also gutted audits of foundations such as Beard, which have been cut 44% since 1998, to 5,754 audits last year—out of the country's 1.8 million-odd nonprofits.

With greed left to take its course, a spate of scandals has erupted among foundations and charities. Last summer the IRS announced a probe into 2,000 nonprofits after congressional investigations revealed inflated compensation packages and insider dealing. But little has happened, since Congress hasn't O.K.'d the \$300 million to fund the crackdown. If it does, it would be only a first step toward a much-needed look into what appear to be widespread abuses of taxpayer money. "This is a large and threatening problem," says Paul C. Light, a New York University public service professor.

Much of the spotlight so far has targeted

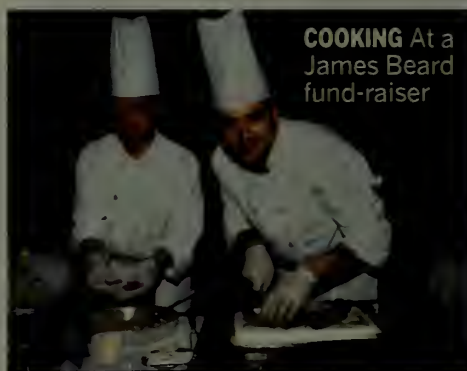
nonprofits whose top execs sport million-dollar pay packages—usually hospitals, universities, and elite cultural institutions. But there's often more egregious abuse among the tiny nonprofits that operate below the radar. While state attorneys general can play a role, it's primarily up to the IRS to put a stop to such nonsense.

Family foundations are one problem area. Financier Paul C. Cabot Jr. took less than \$60,000 a year as a trustee of the Needham (Mass.) Paul & Virginia Cabot Charitable Trust, which his late father founded in 1988 to fund arts and education. But in the mid-1990s the energy company that Cabot ran went downhill. Between 1999 and 2003, he took a total of \$5.2 million out of foundation coffers—while giving away just \$2.1 million. All this was exposed in the Boston media last year, but no legal or IRS action has been announced. Cabot declined comment.

Then there is Peoria's Bielfeldt Foundation. According to the *Peoria Journal Star*, Gary and Carlotta Bielfeldt had given \$26 million to local community groups since 1984 but paid themselves and family members \$21.6 million over that same time. Although the couple endowed the foundation with \$30 million in 1986, they apparently hit trouble, too: They face a \$70 million lien from the IRS. Gary Bielfeldt says he and his family took more like \$14 million. Douglas Stuart, who took over as the foundation's president in September, says he wants it to be independent from now on.

The IRS can prevent more of this. In addition to restoring its nonprofit auditing budget, the agency should require foundations to report all family members on the payroll. Longer term, it could boost oversight by requiring nonprofits to file audits electronically, says Diana Aviv, director of the Independent Sector, a nonprofit trade association. Then it could write programs to highlight out-of-line compensation or suspicious-looking contracts.

Nonprofits pay no taxes, since they help society. But if they help themselves instead, taxpayers end up footing the bill. ■



COOKING At a James Beard fund-raiser

Careless with Contributed Cash

A spate of scandals has hit foundations and charities. Some examples:

JAMES BEARD FOUNDATION Its president was forced to resign after squandering hundreds of thousands of dollars, allegedly on excessive salaries and meals. The New York foundation says it's restructuring.

JAMES IRVINE FOUNDATION The California group spent \$94,000 on its former president's retirement parties in 2002 and gave him a \$25,000 bonus. The state attorney general forced him to return the bonus. The foundation acknowledges the error.

KID-CARE OF HOUSTON The Texas AG settled a case with Kid-Care, which provides meals for poor kids, after alleging the charity had allowed officers to misuse \$640,000. Kid-Care didn't comment. Former officer Carol Porter denies there was any wrongdoing.

BusinessWeek online For more on cleaning up nonprofits, see www.businessweek.com/magazine/extra.htm

Panasonic introduces...



Panasonic ideas for life

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The Panasonic Lumix digital camera with 12x optical zoom and our Optical Image Stabilizer delivers amazing photo results.



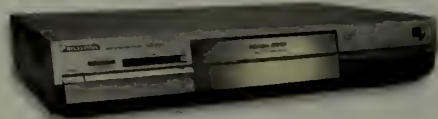
shoot

The D-Snap AV-50 SD Video Camera goes just about anywhere. Lets you take print-quality digital photos, record digital video, play MP3s and make voice notes.



save

DIGA DVD Recorders give you total recording control. Store up to 284 hours of your favorite shows. Preserve your home videos and digital photos.



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Panasonic ideas for life

China's Power Brands

Its consumer goods are hot—and taking on the multinationals

HOW DO YOU GET RICH in China these days? Build a brand. That's what 35-year-old Huang Guangyu has done. The Guangdong native started out at 18, renting a market stall in Beijing and hawking cheap plastic appliances. Today, his GOME Electrical Appliances is China's top consumer-electronics chain, with well over 100 stores, \$2 billion in sales, and the kind of high-plateau brand recognition that Circuit City and Best Buy enjoy in the U.S.

And thanks to a backdoor stock listing in Hong Kong this summer, Huang's net worth is now at least \$830 million. Just one hitch, though. China's domestic retail players, including GOME, are already worried about the impact of foreign competition next year, when Beijing will open the entire country to retailers from abroad.

This little tale neatly sums up the story of China's emerging brands today. Tremendous excitement about the brands, but a good dose of fear about their staying power. Global business executives are certainly agog at the prospect that the next stage of China's superfast development will be the establishment of power brands in everything from retailing to white goods to autos and more—brands strong enough both to dominate at home and thrive overseas. "They are definitely going global," says Glen Murphy, the Shanghai-based managing director of ACNielsen in



WATER EVERYWHERE
Zong's Wahaha,
a leader in bottled
beverages

QUENTIN SHIH/ASIA IMAGES

Marketing China

China. "With their resources and production base, they are large enough to reach out to the world."

There are plenty of well-known local names besides GOME. Haier Group, of course, is the granddaddy, a \$10 billion maker of refrigerators, washing machines, and more, with global ambitions nurtured by its well-known boss, Zhang Ruimin. TCL Corp., with \$3.4 billion in revenue, is so powerful in TVs and other electronics that it reached a deal to merge its television business with that of France's Thomson last

year and took control of Alcatel's cellphone business this year. Lenovo Group Ltd., formerly known as Legend, with \$3 billion in revenue, is No. 1 in China's PC market. Li-Ning Co. Ltd., founded by a Chinese athlete, is the top seller of athletic footwear and apparel. It went public this year, too. The roster goes on and on.

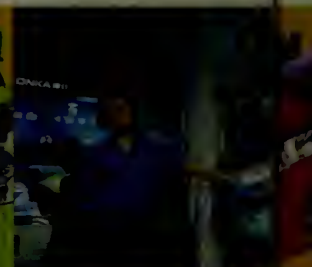
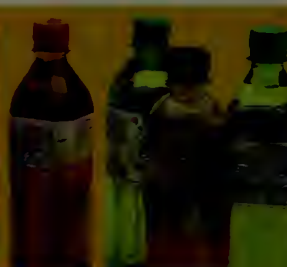
"LIGHT YEARS AWAY"

BUT CHINA BRAND watchers wonder, is this impressive enough? They see the capacity overhang in Chinese industry, the tendency to skimp on innovation, the ever-growing presence of multinationals on the mainland, and the continuing popularity of foreign brands. Share prices for many of China's consumer brand compa-

nies are way off this year. Brand awareness of Chinese companies among U.S. and European consumers is, by and large, low. And for every China brands enthusiast, there's a skeptic. "Export their brands successfully?" asks Tom Doctoroff, CEO for Greater China at U.S. ad agency J. Walter Thompson. "Chinese companies are light years away from it."

Then again, so were the Koreans when they set out 20 years ago to join the stable of world-class brand companies—and no one could have predicted that Samsung, LG, and Hyundai would be the up-and-coming global brands they are now. Like the Koreans, the Chinese are certainly going to stumble. But with all the furious activity going on in the marketplace,

In every **product line**, strong brands are



HAIER

Appliances, TVs

2003 REVENUE

\$9.75
BILLION

2003 PROFITS

\$193
MILLION

SLOGAN

"Honest and trustworthy forever"

» BRAND STRATEGY

Break away from its low-end niche with a push out of small refrigerators and into higher-end products with juicier margins.

» KEY CHALLENGE

Convince overseas retailers and consumers that it can make quality appliances.

» KEY STRENGTH

Already sells at the likes of Wal-Mart, Sears, and Best Buy.

LENOVO

Computers

2003 REVENUE

\$3
BILLION

2003 PROFITS

\$128
MILLION

SLOGAN

"Innovation and excellence"

» BRAND STRATEGY

After unveiling a new corporate name last year, Lenovo hopes its sponsorship of the 2008 Olympics will boost its profile worldwide.

» KEY CHALLENGE

Facing stiff competition at home from Dell, HP, and IBM.

» KEY STRENGTH

The market leader in China and strong in most other countries in Asia.

TCL

TVs, Mobile Phones

2003 REVENUE

\$3.4
BILLION

2003 PROFITS

\$163
MILLION

SLOGAN

"Technology that caters to you"

» BRAND STRATEGY

Linked up with France's Thomson, owner of RCA. Will sell as Thomson in Europe, RCA in the U.S., and TCL in developing markets.

» KEY CHALLENGE

Protectionism: The U.S. levies 21.25% tariffs on its televisions.

» KEY STRENGTH

Strong ties with established brands and network of overseas factories.

WAHAHA

Beverages

2003 REVENUE

\$1.23
BILLION

2003 PROFITS

\$196
MILLION

SLOGAN

"Youth knows no failure"

» BRAND STRATEGY

Plans to use its name to expand beyond beverages and into fast-growing markets such as children's clothing.

» KEY CHALLENGE

Rivals Coke and Pepsi fast expanding beyond coastal China and into the interior.

» KEY STRENGTH

Has unparalleled penetration into China's smaller cities and rural markets.

GOME

Electronic sales

2003 REVENUE

\$2.15
BILLION

2003 PROFITS

\$151
MILLION

SLOGAN

"Wherever we needed—we're there"

» BRAND STRATEGY

Plans to add new stores across China and possibly overseas following the opening late last year of first Hong Kong store.

» KEY CHALLENGE

WTO commitments mean China will open fully to foreign retailers by year end.

» KEY STRENGTH

Has nationwide network of stores and enjoys close ties with electronics-makers.

some of these brands will emerge as real winners. Unlike the nationalist Japanese, some will hook up with foreign companies to get a boost—and some will even use the brand name of their foreign partner when they market abroad, as TCL will with RCA, Thomson's big brand in the U.S. China's huge domestic economy gives these contenders the chance to cut their teeth in the most competitive environment on earth. "Market shares will go up and down. Some Chinese companies will lose. It's a learning process," says Paul Gao, a principal in the Shanghai office of McKinsey & Co. "But there is no doubt that world-class Chinese brands will emerge."

The learning process will involve both

making better products and selling them more effectively. Ogilvy & Mather Chairman and CEO Shelly Lazarus recently led a conference of more than a dozen Chinese companies at the former estate of agency founder David Ogilvy. Lazarus was impressed both by their lack of knowledge—and their hunger. "Most Chinese companies don't yet understand even what we mean by 'positioning' a brand," says Lazarus. "But they are anxious to know. They can't suck it in fast enough. They are going to figure this out. You can see it in their eyes."

Which Chinese companies will be hungry enough to win? China brand watchers pick TCL, Haier, and SVA, a top TV maker. But at this stage in China's tu-

multuous economy, it's hard to say for sure. Overcapacity has reached 30% in many industries, including televisions, washing machines, and refrigerators, putting tremendous pressure on margins. "Home electronics appliance prices are decreasing 10% to 15% annually," says Chen Kaixun, vice-president of Hisense Electric Co., an appliance maker and rival to Haier. "For the price war, the only thing we can do is decrease our costs." Hisense managed 2% profit growth in the first half. The price war has also hit Haier hard; its Shanghai-listed arm pulled off only 6% profit growth for the first half, despite sharply rising sales. And it's not just white goods. Auto prices have fallen 7% in each of the past two years and are expected to

Emerging to challenge the global market leaders



GEELY

Cars

2003 REVENUE

\$484

MILLION

2003 PROFITS

\$58

MILLION

SLOGAN

"A happy life comes with Geely"

BRAND STRATEGY

Move upmarket while maintaining low sticker prices. Overcome low-quality image first in China, then abroad.

KEY CHALLENGE

No joint ventures with foreigners, so it lacks overseas distribution networks.

KEY STRENGTH

Low cost structure compared with major state-owned auto makers.

BIRD

Mobile Phones

2003 REVENUE

\$1.3

BILLION

2003 PROFITS

\$42.3

MILLION

SLOGAN

"The fighter plane of mobile phones"

BRAND STRATEGY

Facing growing competition at home, Bird plans to expand in markets including France, Italy, and India

KEY CHALLENGE

Focused solely on mobile phones, Bird is vulnerable to a telecom slowdown.

KEY STRENGTH

Leads in smaller Chinese cities, where the market will grow most rapidly.

TSINGTAO

Beer

2003 REVENUE

\$907

MILLION

2003 PROFITS

\$31

MILLION

SLOGAN

"Enthusiasm everywhere"

BRAND STRATEGY

Leverage its German heritage and reputation as China's oldest beer to build up image overseas.

KEY CHALLENGE

Growing competition at home; sales abroad largely limited to Chinese eateries.

KEY STRENGTH

Close ties with Anheuser-Busch will help it build reputation overseas.

LI-NING

Clothing, Shoes

2003 REVENUE

\$121

MILLION

2003 PROFITS

\$11

MILLION

SLOGAN

"Anything is possible"

BRAND STRATEGY

Use its sponsorships of up-and-coming young Chinese athletes to grow its brand on the mainland.

KEY CHALLENGE

Faces competition from the likes of Nike, Adidas, and Reebok on its home turf.

KEY STRENGTH

Profile is high due to founder Li Ning, a five time Olympic medalist.

YONGHE KING

Fast Food

2003 REVENUE

\$36

MILLION

2003 PROFITS

\$386

THOUSAND

SLOGAN

"Delicious food, new concept"

BRAND STRATEGY

Will boost service, restaurant atmosphere, and food quality following a \$26.5 million investment by the Philippines' Jollibee.

KEY CHALLENGE

Fast-food in China dominated by McDonald's and KFC.

KEY STRENGTH

Now partnering with Jollibee, which has beaten multinationals at home.

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Marketing China

drop at least 10% this year. The television glut is especially severe—and an aggressive export drive has triggered anti-dumping suits from the U.S. and Europe.

In this punishing environment, China's previous mediocre record in innovation is a liability. It's rare for Chinese companies to meet the international norm of spending 5% or more of revenues on research and development. This spending gap can give multinationals the edge.

TAKING CALLS

THAT'S WHAT happened in cell phones. Between 2000 and 2003, local handset brands such as Bird, Amoi, Panda, and TCL beat Nokia, Motorola, and other global brands on price and flashy features like TCL's gem-studded phone, a big success with the nouveaux-riches. The locals went from a zero share in handsets a few years ago to almost 50%. "We take our Chinese competitors seriously," says Maurice Tan, marketing manager for Nokia China. "They are like a wolf pack."

Yet the wolf pack has been in retreat. In the past year or so, Motorola, Nokia, and Sony Ericsson have rolled out a raft of phones with fancy new functions, pushed aggressively into new markets, and slashed prices. Nokia, for example, has added Chinese handwriting functions, and expanded its relationships with the thousands of small retailers that sell mobile phones across China. Because of the counterattack, TCL has seen its branded



COLD COMFORT
Zhang's Haier has global ambitions

handset market share slip from 8% to 6.1% in the last year and a half: Sales of its mobile phones at its Shenzhen-listed arm dropped almost by a third in the first half, while Bird's sales fell almost 20%. Overall, domestic vendors have seen their handset sales slip from 42% of the market last year to 37% in the first half of 2004. Says Patrick Kung, general manager of Motorola's handset business in North Asia: "The locals did

very well in the past three years. But starting this year, their growth rate has stalled big time."

Foreign manufacturers such as Hitachi and Samsung have also won back market share in high-end plasma and flat-screen televisions, while Panasonic and LG have recovered some of the sales they lost in microwaves to local brand Galanz. In automobiles, General Motors, Ford, and Volkswagen offer budget models for less than \$10,000. That could very well spell trouble for

Geely Auto, a six-year-old brand that has quickly captured 4% of the market with cars that sell for as little as \$3,500. "The next several years will be difficult for local carmakers," predicts Yale Zhang, director of emerging-markets vehicle forecasts at CSM Asia Corp. in Shanghai.

The increasing competition in retail will also hurt, at least in the short run. Today, Chinese companies have an edge in developing relationships with the thousands of small stores and kiosks where most Chinese shop. But with the World Trade Organization-mandated opening of all China to foreign retailers coming at the end of the year, multinationals such as Wal-Mart Stores Inc. and Carrefour will further expand their franchises, making those ties less important. "As the distribution model changes, it is becoming less and less suited to domestic brands, making it easier for foreign companies to penetrate China," says Qu Honglin, general manager of Local Strategy, a Shanghai brands consultancy.

A final issue that Chinese companies have to struggle with is the depth of management. Many of China's best brands were conceived

by heroic entrepreneurs like GOME's Huang or 59-year-old Zong Qinghou. Zong, who spent years laboring in the rice paddies during the Cultural Revolution, is founder of Wahaha, a beverage group that had profits of \$196 million last year. (French company Groupe Danone owns 30%.) A hands-on leader, Zong will lead his managers on a tour of street vendors to see how beverages get sold in China's sprawling sidewalk markets. But he scorns market research, and it's not clear how Wahaha would fare without its charismatic founder.

These are all formidable problems. Yet for every setback, the Chinese find a way to move forward. Indeed, losing a few rounds in the most competitive market on earth is excellent training. Look at Lenovo. Several years ago the computer maker hatched big plans to branch out into

There's excitement about brands—but some wonder if they can last

BIG-SPENDING CHINA

For brands to grow, a market needs consumers to spend and advertising to flourish. Both are happening on the mainland.





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Marketing China

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GOLDEN WINGS in cell phones, Bird has bested Nokia

PDAs, mobile phones, and other areas beyond its expertise in laptops, PCs, and servers. Bad idea: The loss of focus started costing Lenovo—as Dell Inc. stepped up the pressure in China. Lenovo had to lay off 5% of its workforce last spring. But to its credit, the company has refocused its priorities in the China market, and profits rebounded 24% in the first quarter of its fiscal year.

KEEP EXPERIMENTING

OTHER COMPANIES are realizing they can't skimp on research. Over the next few years, TCL will ramp up R&D from 3% of sales to 5%. Television maker SVA Group spends 6%. "We must invest and develop new products," says Chen Hong, vice-president in charge of overseas markets for SVA. "If we focus on price alone, we don't have a future." If foreign connections will help, so be it. TCL, by acquiring Thomson-RCA's TV line and Alcatel's cell-phone business, has acquired Western brand names, distribution networks in Europe, and a bundle of Western technology. Strong sales in televisions in China and abroad helped push up TCL's first half earnings by 44%, despite its serious setback in cell phones at home.

Haier has been criticized by overseas rivals for not understanding how to connect with customers better. "One of the steps that many of the Asian companies have missed is the huge investment that's required to build brand equity," says David L. Swift, executive vice-president of Whirlpool Corp.'s North American region, which has had to do battle with Haier. But Haier is learning. It already spends 4% of revenues on research and is creating local product-develop-

ment teams in Tokyo and the U.S. to differentiate its line and move upmarket. In Japan, for instance, Haier offers washers that use less water, are quieter, and are narrow enough to fit cramped Japanese homes. "In the past, we tried to design our products in Qingdao and sell them to the U.S. and Japan," says CEO Zhang, 55. "They didn't meet overseas consumers' needs and didn't sell well." Today, Haier has 22 factories overseas, including a refrigerator plant in Camden, S.C. Revenues from Haier's overseas operations are up 53% to \$1.3 billion in the first eight months of 2004.

One brand that has seen its global future and acted on it is telecom equipment maker Huawei Technologies Co. It already spends more than 10% of its revenues on research—and is not only competing successfully against outfits like Cisco in telecommunications gear but could emerge as a consumer brand as well. It now makes handsets and set top boxes for TVs. Its formidable research machine could give it a winning hand.

Back home, many parts of the Chinese market are still up for grabs, thanks to the vastness of the country. Wahaha, for example, has built up its market by avoiding head-on confrontations with PepsiCo Inc. and Coca-Cola Co. and focusing on less-developed markets. It is now a big force in provincial capitals like Kunming, Yunnan. Other companies are customizing products for the hinterland. Guangdong Kelon Electrical Holdings Co. has

developed the budget Combine brand of refrigerators and air conditioners for less affluent consumers. Kelon's sales are up 49% this year, and profits are up 11%.

Chinese companies are also learning how to raid the competition. Li-Ning has hired Wu Xianrong, a former manager at Procter & Gamble & Co., to run its marketing and branding. Wu made sure that many of the Chinese athletes at the Athens Olympics wore Li-Ning shoes and other equipment. Such product placement gave Li-Ning an Olympic boost in sales in China, where the company has more than 2,000 outlets and the top spot in athletic shoes, with 12.39% market share. "All of us [Chinese consumer goods] companies must thank P&G for our development," says Li-Ning's general manager Zhang Zhiyong.

Like Westerners, the Chinese are learning how to advertise on a grand scale. Ad spending last year was \$24 billion in China, making it the third-biggest ad market in the world. The ad spending will only increase as the 2008 Beijing Olympics approach. Lenovo already became the first-ever Chinese company to be an official "top" sponsor of an Olympics—up there with Coca Cola and Panasonic—when it signed

on to back the 2008 games. It's part of "a longtime dream to become an international brand," says marketing boss Alice Li.

Meanwhile, the world beckons. Haier has established its foothold in the U.S. TCL, with the Alcatel deal it just signed, has big plans for Europe. Geely Auto has borrowed from the Koreans' early marketing strategy and entered other emerging markets as a first step to overseas expansion, starting with the Middle East.

Some of these efforts will fail. But with every ad campaign, every marketing battle, every product launch, the Chinese learn a little more. Another Chinese juggernaut, like the one that has taken over much of global manufacturing? Not now. But give them time, and the best of these brands will prove themselves. ■

—By Dexter Roberts, with Frederik Balfour in Shanghai, Bruce Einhorn in Hong Kong, Michael Arndt in Chicago, and Michael Shari and David Kiley in New York

In R&D, the push is on—to spend the money to stay ahead of rivals

BusinessWeek online For interviews with China brand masters, go to www.businessweek.com/magazine/extra.htm

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FULL PRICE FOR NOW
Shoppers on Long Island

Santa's Feeling Strapped This Year

Retailers across the country are bracing for what could be a cheerless season

THERE ARE PLENTY OF reasons to be nervous heading into this holiday shopping season if you're a retailer. Consumer confidence fell in October for the third month in a row.

Income growth is sluggish. Energy prices are soaring. No surprise, then, that the winter gift-buying season, when retailers traditionally book most of their profit for the year, is looking less than jolly. Sales at stores open at least a year will increase a modest 3.5% in November and December, down from 4% last year and well below the 5%-plus growth rates of the late '90s, estimates the International Council of Shopping Centers. "It's going to be tough," says Coach Inc. CEO Lew Frankfort.

So what are retailers doing to prepare for a possibly slow holiday season with perhaps too few must-have gift items?

Mostly they are digging in against their customers, keeping inventories at near-record lows in an attempt to avoid the heavy discounting that in recent years has cut into profits and hooked consumers on the 40%-off sale. This strategy is not without risk. If consumers are poised to spend more than many expect, stores

could run out of popular merchandise forfeiting sales. That could hammer profits as much as heavy discounting. Last year sales at retailer Talbots Inc. fell short because it ran out of some hot-selling styles and colors.

GIFT CARDS

RETAILERS CATCH A FEW breaks this year. The crucial stretch between Thanksgiving and Christmas, when most gift buying happens, includes two more shopping days than it did last year. Many retailers are also counting on increasingly popular gift cards to keep cash registers busy. About 60% of time- and idea-strapped shoppers are expected to buy cards this year, up sharply from 45% in 2003, says research firm Bernard Sande LLC. When recipients redeem cards, they tend to spend more than the face value.

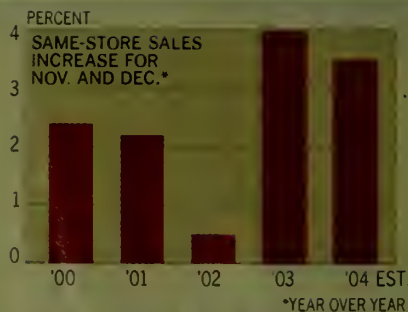
Though not as sexy as coming up with a blockbuster new product line, retailers focus is on inventories as never before. Overall, stores at the end of August had 1.36 months of inventory on hand, down about 2% from a year ago, according to government figures. That's near a historic low. Why the drop? Credit the use of new whiz-bang software designed to help retailers improve how they time deliveries and decide when to cut prices to clean out shelves. Gap Inc., which says inventory is about the same as it was a year ago, recently installed software programs that help it plan markdowns. Casual Male Retail Group Inc., the 500-store men's chain, has spent \$8 million upgrading its systems to avoid stocking too many of the wrong sizes and too few of the right ones.

The combination of such software and low inventories means many chains can hope to feel less pressure to slash prices as the holiday season gets under way. If consumers want hot items like faux fur shawls, MP3 players, and plasma TVs, they may have to buy early, and at full price, if they want to buy at all.

Still, that hardly means there won't be markdowns: They may just come later. With many shoppers conditioned to wait longer for sales, analysts say they're inevitable. "I think retailers will hold out and then discount like mad," says Claire A. Gallacher, an analyst at investment bank Caris & Co. If a few big retailers break down and start running deep discounts early, others will be forced to follow. A chain reaction could generate welcome savings for shoppers—and foil the best-laid plans of store execs. ■

—By Louise Lee in San Mateo, Calif.
with Robert Berner in Chicago

HOLIDAY HO-HUM



Data: International Council of Shopping Centers



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YOUR NEW HEALTH PLAN

Health savings accounts, like 401(k)s, will give employees more choices—but also a greater share of the costs

BY HOWARD GLECKMAN

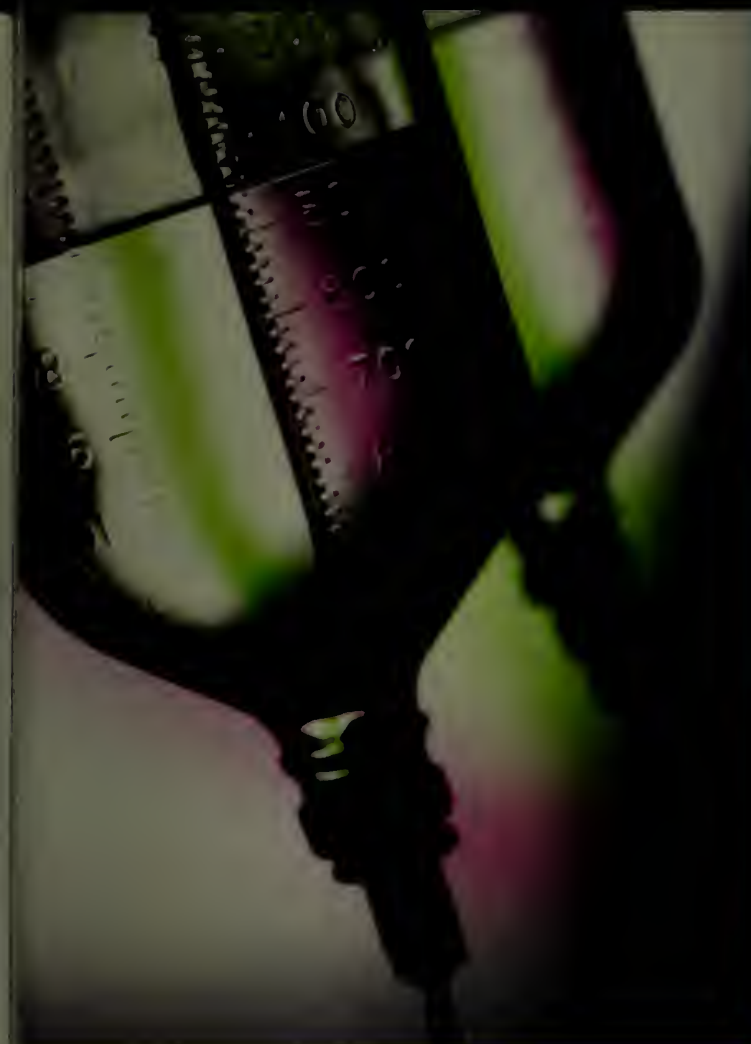
WHEN THE 7,500 EMPLOYEES OF MERIDIAN Health opened their 2005 medical-insurance enrollment packages in early October, they found something new. Along with the traditional plans offering a network of doctors was a new choice called a health savings account (HSA). The employees of the Neptune (N.J.)

health-care company could opt to sock away as much as \$2,000 of their own money tax-free next year in a 401(k)-like account. What's more, they could invest the money in stocks, bonds, or mutual funds and tap into the tax-free account to pay medical costs. They would also keep anything they didn't spend, which means money would continue to grow and be available to buy health care in future years. Workers would pay less in biweek-

ly premiums with the HSA, too: \$15, vs. \$44 if they stuck with the traditional preferred provider organization (PPO) plan.

So what's the catch? A hefty \$3,000 annual deductible, vs. \$1,000 with the PPO. To ease the pain, Meridian will match employee HSA contributions at 50¢ on the dollar, up to a max of \$1,000. It also plans to give them information about the price and quality of medical care in their area, so they can make smarter decisions about what to buy and where to buy it. In 2005, the company expects only 5% to 10% of its employees to sign up, says Human Resources Senior Vice-President John E. Sindoni. But if the idea proves popular, HSAs, which Meridian hopes will give it more control over its medical tab, could become the company's only insurance option in two or three years. "We are looking to curb rising costs, and we want our employees to become more engaged in their care decisions," says Sindoni.

Get ready for the next great experiment in American health



care. In the 1980s, employers embraced health maintenance organizations (HMOs) as the solution to runaway medical costs. But the ensuing backlash in the 1990s forced companies to ease HMO restrictions or replace them with looser PPOs that do little to limit care. When medical inflation returned to nosebleed levels, desperate employers began searching for yet another solution.

The latest answer: HSAs and their cousin, the health reimbursement account (HRA). In 2000, insurance companies first began marketing HRAs, which also allow employers to set up high-deductible plans with lower premiums. With HRAs, employers set up new company-funded accounts that employees use to pay out-of-pocket health costs for, say, visiting a specialist or getting treatment for the flu. Because workers can roll over unused funds at the end of the year, they have a big incentive to shop for cheaper doctors and hospitals.

The Bush Administration expanded the concept in last December's Medicare prescription drug law by creating HSAs, a favorite GOP idea that allows employees to kick in their own tax-free dollars along with their employers'—and to watch the whole pot grow tax-free. Better yet, unlike HRAs, HSA money belongs to the workers, who can keep it to use for future medical spending even if they change jobs or retire.

HSAs, HRAs, and the notion of consumer-directed health care that underlies them hold tremendous promise—and also much peril—for the U.S. health-care system. At its most basic, the idea is to turn medical care into a service that consumers buy like any other. Doing so, the thinking goes, will force everyone—doctors, hospitals, drugmakers, and medical-equipment companies—to rein in prices. "HSAs are part of a larger transformation of the health-care system," says Paul Fronstin, an economist at the Employee Benefit Research Institute. "It is not as simple as mere dollars. It is about combining dollars with the ability to choose providers differently."

Yet there are plenty of pitfalls that make the outcome highly uncertain. HSAs may appeal mostly to healthy and affluent families who will opt for lower monthly premiums, betting they can handle big out-of-pocket costs if they get sick. But the less healthy may remain in traditional plans, making them even more costly.

Uncharted Waters

WHAT'S MORE, IT'S BY NO MEANS clear that health care will conform to the logic of the market. If the forces that HSAs are designed to unleash don't curb prices, employees may end up shouldering more of their expenses. Indeed, many companies like the HSA idea because it allows them to manage costs better. If overall medical spending rises faster than expected, workers will absorb much of it through HSAs' higher deductibles. The concept is similar to 401(k)s, which limit employer retirement contributions rather than guarantee a monthly pension check.

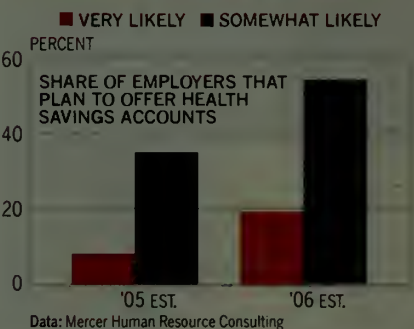
PUTTING CONSUMERS IN CHARGE

Get ready for the next great experiment in American health care. As medical inflation hits nosebleed levels, desperate employers are eager to adopt schemes to shift costs to employees.

To rein in soaring medical costs...



...employers plan to embrace 401(k)-type health accounts...



...giving workers new subsidies

- Health savings accounts, which Congress created last year, allow employees to set aside pretax dollars for medical care.
- Workers can invest in stocks, bonds, or mutual funds, and the money grows tax-free, but it can be spent only on medical expenses.
- Employers can contribute to their workers' HSAs if they wish.

...but also more responsibility for decisions and costs.

- HSAs' large deductibles are designed to give workers more control over how their health dollars are spent.
- Employers plan to give employees more information about the cost and quality of doctors and hospitals in their areas, as well as incentives to use the most cost-effective providers.
- But workers will shoulder a greater share of any future medical inflation.

The big question: Will HSAs slow medical inflation—or hurt patients?

- By putting Americans in charge of their own health-care spending, proponents hope that HSAs will turn them into more careful consumers, easing cost hikes.
- But the scheme could backfire if patients skimp on care to save money. And if healthy workers sign up for HSAs while sicker ones stick with traditional plans, the cost of old-style insurance will soar.

"The hope is that employers will shift the cost burden to employees, and employees will shift it to [health-care] providers," says Dearborn (Mich.) benefits consultant Maureen Cotter. If not, "employees will be left holding the bag."

The creation of HSAs received virtually no public notice last year, but Corporate America has snapped to attention. Already about 10% of employers offer consumer-driven plans, mostly HRAs, although only a few million workers have signed up for them. But experts and corporate planners expect HSAs to jumpstart the concept. Since the accounts are so new, most large employers haven't yet worked through all the complicated details involved in setting them up. So HSAs are being offered this fall only by several hundred smaller companies, plus a handful of large ones such as BASF, Intel, Pitney Bowes, and Textron.

But by 2006, fully 73% of U.S. employers are likely or somewhat likely to be offering HSAs, according to a survey by Mercer Human Resource Consulting. Health economists aren't sure how many employees will buy in. But as many as 32 million people, or 20% of the 160 million Americans insured by employers, could sign up for some form of a high-deductible, consumer-driven account during the next five years, says Edward Kaplan, national health-practice leader at Segal Co., a consulting firm. Already, 10 million federal government employees will have an HSA option



sure most of the uninsured. This leaves him in an odd position vis-à-vis HSAs. Kerry doesn't oppose them, although he does object to ending employer-based care. If Kerry becomes President, he's not likely to seek to repeal the law that permits HSAs. But he surely wouldn't actively promote the plans as Bush will continue to do if reelected.

Consumer-directed health care is no panacea, but if it delivers on its promise, it could bring much-needed relief from the industry's punishing price spiral. For example, showing consumers the cost and health risks of a hip replacement could encourage them to opt for physical therapy. Or allowing them to compare MRI prices at three local imaging centers could spur competition. Advocates also say that giving consumers more responsibility will prod them to curb unnecessary care, which some studies peg at 20% to 30% of all U.S. medical spending. "This will be the most important effect of consumer-driven care," says Harvard Business School Professor Regina E. Herzlinger.

Overall, consumer-driven care could lower the \$8,000 tab for the average worker's medical care by perhaps 5% to 10% over the long term, according to estimates by Emory University health economist Kenneth E. Thorpe. That won't solve runaway medical spending, but it would still ease some of the pain for employers and employees alike.

The groundwork for HRAs and HSAs was laid by employers in the late 1990s, when they started moving toward higher deductibles. As Corporate America has struggled with resurgent health expenses, companies found it difficult to shift more of the premium onto employees. After all, just keeping pace with medical inflation has doubled annual worker premiums since 2000, to an average of \$1,565. But employers realized that increasing deductibles and co-payments was less noticeable, since most people don't use the medical system much in any given year. So they have been hiking annual employee out-of-pocket costs sharply in recent years. In 2004, they will top \$1,000 per employee on average, up from \$446 in 2000, according to Hewitt Associates LLC. As a result, workers' share of total costs has jumped from 26% to 32% since 2000, Hewitt found, even though they still pay roughly 28% of premiums, the same as in 1998.

HSAs allow employers to continue down this path. Instead of taking painful steps to

slow health spending, such as denying coverage for some treatments, high-deductible plans shift the burden of decision-making onto employees. They can opt for brand-name rather than generic drugs or go to a more costly specialist, but they pay more. Consumer-driven plans also allow families who don't spend much on care to save a bundle by assuming more risk. In effect, HSAs let employees cut back on their fixed annual costs while insuring themselves, up to the limit of their new deductibles.

Just as these policies will require workers effectively to self-

come January. "These are a big deal; this is what the industry is talking about," says Gary Claxton, director of the Health Care Marketplace Project at the Henry J. Kaiser Family Foundation.

Politically, HSAs could advance President Bush's goal of fundamental health-care reform. He pushed for the HSA provision in the Medicare bill, and he talks on the campaign trail about expanding it. The approach dovetails with his platform of new tax cuts to help Americans buy insurance on their own, instead of through employers. His aim is to give consumers incentives to shop for care and, in the process, help hold down prices. Conservatives hope that, ultimately, all these measures will entice Americans to abandon the employer-based system altogether. Doing so, they argue, would allow workers to tailor insurance to their own circumstances while simultaneously injecting much-needed market discipline into the industry. Such sweeping change would be far more radical than HSAs, but the new plans move in that direction.

Democratic candidate John Kerry, by contrast, is looking for ways to shore up the employer system. He backs an ambitious plan to subsidize about 10% of businesses' premium costs and in-

**SINCE 2000,
WORKERS'
SHARE OF
MEDICAL
COSTS HAS
RISEN FROM
26% TO 32%**

SPECIAL REPORT

insure for the first dollars they spend on medical care, it will let employers reduce the coverage they now provide for that same care. Consumer-driven plans "are shifting to the consumer a greater proportion of the responsibility," says Tracy Bahl, CEO of Uniprise, the UnitedHealthcare unit that markets HSA and HRA plans.

Take Cincinnati's American Financial Group Inc., which just rolled out the 2005 options for its 5,000 U.S. employees. They'll be able to choose between a \$315-a-month PPO with a \$250 deductible, a \$235-a-month HRA with a \$1,600 deductible, and a \$65-a-month HSA with a \$2,200 deductible. Workers who think they won't get sick might jump at the HSA. After all, they would be able to save a cool \$3,000 in lower premiums next year if they don't use the medical system.

If they were real gamblers, workers could pocket all \$3,000 and put nothing in their HSA, betting they would encounter no health problems. Or they could invest some of the saved premium, say \$2,000, in their tax-free account. If they don't spend it on health care, it would remain to be used in 2006 and beyond—along with any interest or stock gains it earned. Plenty of Americans might be willing to run these risks, since fully half the population spends little or nothing on health care in a given year, according to the Kaiser Family Foundation.

Sea Change

THE LARGER GOAL is a profound shift in the relationship Americans have with providers of health care. Today, most people accept the doctor's treatment suggestions without question, including recommendations on which drugs to take or specialists to see. When it's their own money at stake, the theory goes, patients will question procedures and shop around for the best price and quality.

Some companies with HRAs say even this more limited form of consumer-driven care changes behavior. Last year, Equitrac Corp., a 500-employee document-management company in Plantation, Fla., replaced its PPO plan with an HRA. Financial Controller Michael Myers says the company is already saving money. Lilly Bailey, who works in Equitrac's accounting department, says she has been a more careful consumer since getting the plan. "Shopping around is a good thing; your objective is how much you can not spend."

Sounds sensible, but will it work on a large scale? For one thing, consumers can't buy wisely unless they know a lot about the price and quality of the medical services they buy—information that is just beginning to become available today. And neither providers nor insurers have much incentive to show such transparency (page 94). Even if they do eventually make information available, individual consumers may not be able to get better deals than insurers with massive market



HSAs HAVE LOWER PREMIUMS, BUT SOME PLANS HAVE ANNUAL DEDUCTIBLES AS HIGH AS \$5,150

clout. That's one reason why even employees with HSAs will probably continue to buy through provider networks, whose prices have been negotiated by insurers.

Another big question: Will high deductibles lead Americans to stop wasting money on unnecessary care? Or will consumers suddenly in charge of their own health care actually spend more as providers unleash their new marketing muscle? Just think about the proliferation in the past few years of companies hawking direct-to-consumer MRI screenings and do-it-yourself tests that check for everything from anemia to gout. Quest Diagnostics Inc. in Teterboro, N.J., began offering its QuesTest blood workups to consumers in 2001. By early next year, it will have 800 labs marketing everything from simple blood typing to a \$115 "health profile" that includes information on your cardiovascular health, liver function, and immune system. Such tests may be a good deal for many newly cost-conscious pa-

tients, but slick marketing may also encourage some to buy more unnecessary care. "At the end of the day, is health going to be any better? The jury is out, but that's the challenge of market-delivered health care," says Eric B. Larson, chair of the Board of Regents at the American College of Physicians.

At the same time, there's a growing concern that HSA-type plans may prompt people to scale back care that is key to good health. In the long run, that could leave Americans sicker and make their eventual treatment even more expensive than under the current system. The issue is especially important for low-income workers and those with chronic diseases. After all, just five chronic conditions including heart disease and hypertension, account for one-third of all health spending Thorpe figures.

Indeed, scores of studies over the past 30 years suggest that many people will skimp even on necessary treatment if they pay for it

EARLY ADOPTERS

Dozens of large companies are in the vanguard of offering health savings accounts for their employees, usually as a new option along with traditional plans:

BASF
Guidant
Intel
Meridian Health
Pitney Bowes
Textron

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out of their own pockets. For instance, a 2003 study reported that when one employer boosted prescription drug co-payments, 21% of patients in the plan stopped using cholesterol-lowering drugs, more than twice the rate of those who paid less for the same medicine.

In consumer-driven plans, once workers blow through their deductibles, they are back on insurance, so the risk is limited. Still, insurers leading the way, such as Lumenos, Aetna, and UnitedHealthcare, are aware of the problem and are trying to

ease the burden by including free preventive care in their HS or HRA plans. Employers may also exclude drugs for chronic illness from deductibles. In addition, companies such as Meridian are tying their high-deductible plans to disease management programs, which identify people at risk for costly chronic illness such as diabetes or congestive heart failure and assign coaches to help with appropriate treatment. "If people make choices to avoid [needed] care, that's a mistake on our part," says Tony Miller, chief executive of Definit

HOW MUCH IS THAT BRAIN SCAN?

If turning Americans into price-conscious health-care shoppers is ever going to work, it will require wholesale changes in many of the industry's most basic business practices. Today, even the most routine information that patients need to make smart purchasing decisions isn't readily available—or simply doesn't exist. Insurance companies leading the way on consumer-driven plans such as health savings accounts (HSAs) are attempting to fill the gap with piecemeal data that they compile themselves. But it's a vast undertaking.

Take pricing. At many hospitals, the cost of a procedure is either unavailable or just plain indecipherable. Hospitals maintain that their voluminous fee schedules, called chargemasters, are tantamount to trade secrets and have fought to keep them out of the public eye. After an outcry over the high fees that some hospitals charge the uninsured, California this year began requiring hospitals to publish their prices.

Other states are expected to follow suit.

But what might seem like a victory for consumer empowerment is really just a small first step. Why? Because individuals don't gain much even if they do get their hands on a hospital's master price list. Chargemasters typically show every procedure in excruciating detail. But the biggest consumers of hospital care—insurance companies—negotiate deep discounts that providers don't offer directly to the public. A hospital might charge an insurer a flat rate for heart surgery, which

includes everything from drugs and X-rays to the surgeon's time. But even some insurers administering HSAs haven't decided whether they will release such sensitive data to HSA enrollees. "Health care is the only commercial venture in America where people can't get information about what a procedure is going to cost them," says California State Assembly Majority Leader Dario Frommer.

Comparing quality is an even bigger problem. Few people check a hospital's infection rate before deciding where to go for surgery. But even if they want to, such information can be misleading. A high hospital mortality rate might reflect substandard care or simply a busy emergency room. "There's a lot of controversy about how to adjust for hospitals that treat patients who are sicker than others," says Stephen Jencks, head of quality coordination at the Centers for Medicare & Medicaid Services, which began collecting quality data this year.

As traditional insurance companies and providers grudgingly adapt to this changing world, newcomers are bypassing the old system altogether with direct-to-consumer marketing that promises not only care but also convenience, price, and peace of mind. MinuteClinic Inc.'s tiny express clinics, for example, promise no waiting to visit a nurse in the local Target store. Patients can drop in

seven days a week and choose from a menu of treatments for common ailments such as strep throat or pink eye. A 15-minute visit usually costs

QUICK FIX MinuteClinic promises little waiting

less than \$50—less than a doctor visit. If there's a line, patients can take a beeper and shop while they wait. The Minneapolis-based company says 85% of its patients come for the convenience. "For common illnesses, there's no reason to wait for an appointment or to drive a long distance," says MinuteClinic's chief executive officer, Linda Hall Whitman.

So get ready for the shakeup in health care—but don't expect a true free market to materialize any time soon.

—By Lorraine Woellert in Washington



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Health Corp. in Minneapolis, the nation's largest provider of consumer-driven policies.

Even if many families do become smart health-care shoppers, there's another big risk: that HSAs will separate the healthy from the chronically sick and undermine the risk-pool nature of traditional insurance. HSAs will probably appeal most to the 50% of Americans who spend virtually nothing on care in any particular year. After all, any unused HSA money is theirs to keep, while joining a PPO or HMO means shelling out higher premiums even if they never see a doctor all year. And if employees with heavy medical expenses remain in traditional plans without the current subsidy from non-users, those policies could become unsustainably pricey. That has not happened with the early HRA plans. But some analysts are worried. "Sicker people are going to wind up paying more," predicts Karen Davis, president of the Commonwealth Fund, which studies health-care issues.

Getting an Easy Ride

SOME EXPERTS ALSO PREDICT that plans with high deductibles will be affordable only for those who are both healthy and affluent. HSAs open up a new tax-free savings strategy that's far more generous than 401(k)s, individual retirement accounts, or Roth IRAs. While all these allow either pretax contributions or tax-free withdrawals, HSAs are entirely tax-free, as long as you use the funds for medical expenses. "You get the Triple Crown of tax planning: It goes in tax-free, it grows tax-free, and it comes out tax-free," says Andy Anderson, a benefits attorney at Hewitt.

That may create a sweet new shelter for high-income families that have already maxed out on their 401(k) contributions. HSAs thus could offer a great way to save for post-retirement health care, which many employers have dropped. Yet even more companies may dump the benefit once their workers have a pot of money with which to buy their own.

Trouble is, most middle-income families pulling down \$45,000 or \$50,000 a year probably can't afford to put aside thousands of dollars, even if Uncle Sam kicks in so much. Fully 96% of workers already contribute less than the maximum to their 401(k)s. And many may feel compelled to choose between their 401(k) and an HSA, potentially diverting savings from retirement to health care. "We are concerned about that," concedes American Financial's director of human resources Scott Beeken.

It's too early to know whether empowering consumers will make a big dent in the nation's medical tab. If it does, families and employers will gain some much-needed relief and enjoy better health care. But the prognosis will be much more dicey if HSAs and HRAs attract mostly the healthy Americans who aren't much of the problem in the first place. Either way, workers are about to begin a new chapter in the great American health-care saga. ■

-With Lorraine Woellert
in Washington

HOW WILL THE PLANS WORK?

Here are some quick questions and answers about the alphabet soup of medical accounts

Health savings accounts, which Congress authorized in 2003, are the newest addition to the alphabet soup of health insurance available to American workers. Now workers and employers must sort through HSAs, health reimbursement accounts (HRAs), and flexible spending accounts (FSAs). Each has its own rules about how money is spent, how it can be saved, and how it is taxed. Here's a road map through the complex new world of health insurance:

How do the plans differ from each other?

FSAs, familiar to many workers at large companies, allow you to contribute pretax dollars to an account managed by your employer. You use the money for health-care spending but forfeit anything left over at the end of the year.

HRAs are tied to high-deductible policies. They are funded solely by your employer and give you a pot of money to spend on health care. You can carry over unspent money year to year, but you lose the balance if you switch jobs. Premiums tend to be lower than for traditional insurance but higher than for HSAs.

With HSAs, which are also linked to high-deductible coverage,

you contribute your own pretax dollars to a health account. You can invest the funds in stock, bonds, and mutual funds—just like a 401(k). Unlike a 401(k), the money grows tax-free but can be spent only on health care. And it's your money: Any unspent funds stay in your account year to year, and you take it all with you if you leave the company.

What are the rules for an HSA?

To qualify, your insurance policy must have an annual deductible of at least \$1,000 for singles or \$2,000 for families. Your annual tax-free contributions can be no more than your deductible, up to a maximum of \$2,600 for singles and \$5,150 for families. Both contribution and deductible levels will rise with inflation.



HSAs COULD PIT THE HEALTHY AGAINST THE CHRONICALLY SICK

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SPECIAL REPORT

How does the deductible work?

Say your plan has a \$1,500 deductible. You can contribute up to \$1,500 to your account each year. Or you might contribute \$1,000, and your employer might kick in \$500. But whether you contribute or not, you must pay the first \$1,500 of your health costs. Once you do, regular insurance kicks in, and your company might pay 80% of costs while you pay 20%, although your pretax dollars would be used up unless your HSA has had a chance to accumulate. Finally, when you reach an annual out-of-pocket maximum—say \$5,000—the company policy will cover all costs.

What about preventive care?

Most HSA plans allow you to get certain preventive care, such as an annual checkup, at no cost. Your employer can also choose to provide drugs for chronic illnesses at no charge. But you may have to pay for certain routine tests, such as mammograms or prostate screenings, if you want them more frequently than the plan permits.

What if I have a chronic disease, such as diabetes?

Many companies are offering programs called disease management, which identify people who are at risk for chronic illnesses. Those workers are assigned health coaches to help them manage or even avoid such diseases. If, for example, you are overweight, your employer might provide a diet and exercise program for you.

Will I spend more overall with an HSA?

That depends on how much medical care you buy. If you get sick, you probably will spend more than under a traditional plan. But HSAs' monthly premiums tend to be much lower, so people who don't use the medical system a lot will save money.

Can my employer contribute to my HSA?

Yes, although it is not required to. And you get to keep any company contributions when you change jobs, as you would with a 401(k). Employers can increase their funding to keep up with health inflation, but they don't have to. Current rules require them to make the same match to all workers, no matter how much eventually accumulates in employees' HSA accounts.

Can I use both an FSA and an HSA?

Legally, you can use your FSA money to pay for monthly premiums and for uncovered care such

as dental or vision but not for most medical care. You can use only your HSA account for that. However, because of the possible confusion, some companies that offer HSAs may not allow participants to use an FSA as well.

How about an HRA and an HSA?

Under current rules, your employer can switch from an HRA to an HSA, or even offer both plans and let you choose between them. But your company cannot match your HSA with its own HRA contribution, which many employers would prefer. It can put in only money that you control and can take with you if you change jobs.

Will individual consumers be able to muster enough market clout to get the best deals?

You won't be expected to haggle over price with your doctor or hospital. Insurance companies will continue to offer networks of providers for you to choose from. Eventually, they hope to provide lots of data about the price and quality of those doctors and hospitals. But if you go out of network, you're on your own.

HSAs HOW THEY WORK

1 Your company offers a health insurance policy with an **annual deductible** of at least \$1,000.

2 As with a 401(k), you can put **pretax dollars** into an HSA each year, up to the amount of the deductible—but no more than \$5,150 for family coverage or \$2,600 for individual coverage.

3 You withdraw the money from your HSA tax-free, but it can only go for your **family's medical expenses**. After the deductible and co-pays are met, insurance still typically covers 80% of health costs.

4 HSA plans are required to have maximum **out-of-pocket spending limits**, \$5,000 for individuals, \$10,000 for families. That's when your company's insurance kicks in again at 100% coverage.

5 Your **company can match** part or all of your HSA contributions if it wishes, just as it does with 401(k)s.

6 You can invest your HSA in stocks, bonds, or mutual funds. **Unused money remains** in your account at the end of the year and **grows tax free**.

7 You can also take your HSA with you if you **change jobs or retire**.

8 To help you **shop for health care** now that you're spending your own money, employers say they will give you detailed information about prices and quality of doctors and hospitals in your area.



Will my relationship with my family doctor change?

You will still be able to go to your regular internist or family practitioner. But consumer-driven plans like HSAs and HRAs do encourage patients to get outside advice. Typically they're linked to extensive Web-based and telephone assistance operated by insurance companies. The idea is for you first to call or check out the Web site if you suffer a non-emergency illness or injury. A nurse will tell you whether you need to see a doctor, or whether you can manage the problem with watchful waiting or over-the-counter medications.

Will this new approach eventually lead to a two-tier medical system?

The extensive tax breaks HSAs involve clearly benefit the wealthy more than low-income workers. But the bigger risk may be from divisions between the sick and the well. The fear is that healthier younger workers will use HSAs, leaving older, sicker workers in old-style PPOs. That will make those plans riskier and boost premiums for those who remain in them. Experts also worry that less educated workers may have trouble taking advantage of Web-based information. ■

—By Howard Gleckman
in Washington

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Hopping Aboard The Daddy Track

Suddenly, achieving a work-life balance isn't just a women's issue



PETER BRAND IS A MASTER of the work-family juggle. In the morning he dresses his three-year-old son and one-year-old daughter and drops them off at day care. At the end of the day, the 30-year-old senior manager at PricewaterhouseCoopers struggles to leave the office to get to his Rockwall (Tex.) home. Not at 8 or 9 p.m., the way the previous generation of partner-trackers did, but by 6 p.m. That gives Brand plenty of time to eat dinner with the kids, scrub them in the bath (or do dishes if his wife, Marcy, is handling that), and let Dylan, 3, choose a bedtime story and a prayer—before Brand logs on to do more work. Marcy, an investor relations manager at Southwest Airlines Co., picks up the kids on her way home but, Brand says, “I want to be involved as much as I can in their lives.”

A decade ago, the sight of Brand blowing through the exit doors before supper might have earned him the label of short-timer, at the least. But Brand and his spouse, on equally high-powered career tracks, want to be co-CEOs of their family. And in PwC, Brand has an employer that actually encourages the practice, offering new fathers three weeks’ paid leave in the child’s first year, formal flexibility policies, and strong messages from the top that it’s O.K. for staffers to adapt their schedules to family needs. Says Brand: “I’m more motivated by the flexibility than the money.”

FAMILY-FRIENDLY

IN MAKING FAMILY time as much a priority as his career, Brand is not alone. Working men born between 1965 and 1979 now spend about 3½ hours a day with their kids—the same amount as working women, according to a 2002 study by the Families & Work Institute. Among all working men studied, the average was about 2.7 hours in 2002, up from 1.8 hours in 1977. Moreover, 70% of men said they would take a pay cut to spend more time with their family and almost half would turn down a promotion if it meant less family time.

To be sure, making it to the top still requires sacrifices that often impinge on family time for both men and women. But a significant shift in mind-set and behavior, especially among

GENERATION FLEX
Brand’s employer encourages his co-parenting

younger men, is making itself felt throughout Corporate America. And companies, in order

to lure the best and the brightest, are responding. Employers from Bristol-Myers-Squibb to the hard-driving culture of Texas Instruments Inc. have noted a marked increase in the number of men taking advantage of flexible work programs and child-care resources.

Executives at company-first General Electric Co. also note the change in zeitgeist. The culture is even evolving at Wall Street investment banks like Credit Suisse First Boston, where Brian Finn, the 44-year-old co-president, works from his Long Island (N.Y.) home every Friday so he can spend time with his three kids. At Ernst & Young LLP, close to 20% of the 2,300 people working on flexible schedules are men, up from 17% last year. The firm recently promoted two men to partner who were largely working from home.

More and more, the hard work of raising a family is a growing priority for men, especially Gen Xers whose upbringings were often marred by split parents, empty houses, and dads who seemed like distant relatives. These younger men are clocking their formative career years in the era of the disposable worker, when bosses push the eject button even on once-untouchable MBAs. That erosion of job security, along with the rise of free-agent workers, has led to lower levels of job loyalty and a sense that other things matter, like family. Moreover, given that Americans are marrying later in life, women have often built formidable careers by the time they wed and aren't as content to put their aspirations on hold once they have kids.

TECH ASSIST

OTHER FACTORS HAVE simply made it easier for working parents to be with their families. Policies aimed at helping working women—starting with the 1993 Family and Medical Leave Act—have benefited men as well. Technology plays a crucial role, since it's now easy to stay connected from the sidelines of a soccer game or the bedside of a sick child, never mind with colleagues or customers in other parts of the world. While Paulette R. Gerkovich, senior director of research at Catalyst Inc., which tracks women in Corporate America, concedes that work-life balance is “still seen as a women's issue,” she notes that studies show it's actually of equal importance to men.

The shift in attitudes among male workers is evident to veteran staffers such as Betty Purkey, who manages work/life strategies at Texas Instruments. Not only are men, who make up 70% of the chip-

The New Dads

Younger men are spending more time with their families and opting more for the Daddy Track than older men

Mom used to be the main caregiver...

HOURS SPENT WITH CHILDREN ON AVERAGE WORKDAY	
1977	1977
3.3	1.8
Mothers	Fathers

...but now younger dads are equally involved...

2002	2002*	2002*
3.4	2.2	3.4
Mothers	Boomer fathers	Gen X fathers

...doing more household chores...

HOURS SPENT ON HOUSEHOLD CHORES ON AVERAGE WORKDAY	
1977	2002
1.2	1.9
Married men	Married men
1977	2002
3.3	2.7
Married women	Married women

...and choosing family time over more career responsibility...

COLLEGE-EDUCATED MEN WHO WANT JOBS WITH MORE RESPONSIBILITY	
1992	2002
68%	52%

...so kids are spending more time with their parents than in the past

HOURS THAT WORKING COUPLE SPENDS WITH CHILDREN ON AVERAGE WORKDAY	
1977	2002
5.1	6.1

*Gen Xers defined as those aged 23-37 in 2002, boomers 38-57 in 2002
Data: Families & Work Institute, Labor Dept

maker's employee base, clamoring for more flexibility, but they frequently crowd into the company's classes for new parents. “They really want to spend more time with their families,” marvels Purkey, who finds a pronounced difference among younger employees. In a Bristol-Myers-Squibb survey of its staff, 20% of men and 14% of women reported working from home at least one day a week without a formal arrangement.

General Electric, known for grueling work schedules and nomadic executives, has noticed an increase—albeit slight—in men taking advantage of formal flexible work arrangements. Susan Peters, vice-president for executive development, knows of a number of executives who took parental leave or who duck out early to coach their child's soccer team. “These are things I would not have heard about five years ago,” she says. But the biggest change is in a new unwillingness of people to relocate, which has increased significantly from a decade ago. A working spouse is a major reason, but many also cite reluctance to uproot children. “This is an evolution culturally, both inside and outside GE,” she says.

Men's sharpened focus on family time isn't just a function of a two-career marriage. In survey after survey, men with stay-at-home wives insist they want to spend more time with their kids than men did a generation ago even if it means taking a cut in pay. Joe Colavito of Norcross, Ga., left a high-paying job as an executive recruiter last year to become director of external development at Wells Real Estate Funds Inc. Colavito, 40, barely saw his five children during the week when he was a recruiter. “I felt empty,” says Colavito, “and I know my relationship with my kids suffered.” He's still struggling to forge a closer bond with his 5-year-old daughter, who barely got to know him during his high-stress career.

Of course, the evolution only goes so far. Women still are handling the bulk of child care and are more likely to use an employer's formal flexible work schedules to meet family demands. Among older workers, men spend about an hour less time at home on work days than women. And for both men and women, using work-family policies can still bring penalties.

But the stigma is lessening, and the notion that men can openly embrace their family lives is clearly gaining more acceptance. As men increasingly opt for more family time, the playing field may become more equal for everyone. ■

—By Diane Brady in New York

Taking Aim at The Big Board

The CEO of upstart exchange Archipelago is going after his biggest rivals

THE SON OF A CAREER army officer, Gerald D. Putnam knows his way around weapons. He learned to handle a rifle in his family's homemade basement shooting gallery in West Philadelphia. Nowadays, he uses bows and arrows to hunt deer in Wisconsin. But as the chief executive of Archipelago Holdings Inc., which operates the upstart ArcaEx stock exchange, Putnam mostly targets rival electronic markets such as NASDAQ and Instinet Group Inc.'s INET. And now he's chasing even bigger game. Says Putnam: "We've got the New York Stock Exchange to work on."

Should his competitors worry? Given Putnam's record, they would be foolish not to. In less than two years, ArcaEx has grabbed a fifth of the volume in NASDAQ-listed stocks. Already, Archipelago's market cap, at \$764 million, is more than NASDAQ's \$515 million. Also, ArcaEx' powerful computers now handle nearly a third of the volume in exchange-traded funds listed on the American Stock Exchange. Putnam is "a true visionary," says Alfred Eskandar, corporate strategy director for trading network Liquidnet Inc.

The trick for Putnam, though, is how to keep Archipelago growing. After soaring last year, ArcaEx' share of NASDAQ-listed

trading has plateaued as NASDAQ and INET keep their traders loyal with sharp cuts in fees. Putnam, 46, has refused to follow, arguing that his system's cutting-edge technology for executing trades is worth his higher fees. So he's mounting a three-pronged strategy: shop for deals that will bolster ArcaEx's volumes, persuade companies listed on the NYSE or NASDAQ to add dual listings on his exchange, and expand into equity options trading or other financial instruments.

Putnam charges into this battle flush with cash. He has \$173 million on hand, including \$58 million raised in Archipelago's initial public offering in August, and he's generating more every day. Merrill Lynch & Co. analyst Colin Clark expects Archipelago to earn some \$52.3 million this year on \$538.2 million in revenue. What's more, the company's stock, up \$5 from its IPO price, to \$16.50 a share, gives him a handy currency.

The most likely targets are NASDAQ and Instinet, and Putnam hints at some sort of deal with one of them, though he won't say more. NASDAQ isn't keen on selling, but that doesn't rule out an alliance. Reuters Group PLC has signaled it would like to sell its 63% stake in Instinet, but such a deal would be pricey. The outfit, now valued at \$1.6 billion, operates an institutional brokerage operation as well as an electronic market-

place. Regulators would also need to sign off on a deal that shrinks three markets to two, and could hear complaints from the odd one out.

Putnam might have more to gain by training his sights on the NYSE, especially since Arca handles less than 2% of the volume in NYSE-listed stocks now. This explains all the commercials for ArcaEx popping up on TV during the baseball playoffs. It's spending \$20 million on marketing this year to build name recognition and get executives to list their shares on ArcaEx, too. It already has about 230 dual listings—including IBM, Wal-Mart, Sears, Charles Schwab, and AT&T—the result of its alliance with the Pacific Exchange in 2000. Its campaign will get a big boost if regulators make changes they are mulling that could favor electronic trading at the expense of New York's floor-based system. "The NYSE market is the wide-open field right now," says Robert M. Hegarty, a vice-president at the TowerGroup research firm.

Give Putnam points forchutzpah. An ex-stockbroker, he got the idea for ArcaEx in 1996 as the Securities & Exchange Commission was drawing up rules aimed at encouraging NASDAQ and new electronic networks to display customers' stock orders. After NASDAQ officials brushed him off—once telling him, he says, to "write his congressman" if he wanted changes in the markets—he blazed his own path. "He saw an opportunity and he delivered on it," says analyst Clark.

SOLID BACKING

TO DEVELOP THE technology, Putnam teamed up with a couple of Chicago software experts who had devised a stock-quoting system. Then he persuaded deep-pocketed investors, including Goldman, Sachs & Co. and J.P. Morgan Chase & Co., as well as the likes of E*Trade Financial Corp., to back him. "I can't imagine how often he was told this is a stupid idea," says William E. Ford, a general partner at his biggest backer, General Atlantic Partners LLC, a Connecticut private-equity firm with a 22% stake.

Coming out on top has long been the Philadelphia native's goal. As a high school student in the 1970s, he threw himself into rowing for a private club team. Putnam, who sports the burly shoulders of a rower, led four-man sculling teams to world championship matches in his junior and senior years, sticking with the sport until his junior year at the University of Pennsylvania. He was a "driven individual," though "mischievous," and rowing focused him and

HITTING HEADWINDS

After a sharp runup, ArcaEx' share of trading in NASDAQ stocks has plateaued





Gerald D. Putnam

The ex-rower learned focus—and is building a war chest

BORN May 21, 1958

CURRENT POSITION CEO of Archipelago Holdings, operator of the ArcaEx electronic stock exchange

LEISURE HOBBY While growing up in West Philadelphia, he got his first taste of the markets through an uncle who traded stocks and taught him how to read stock tables

EDUCATION B.S., economics, University of Pennsylvania

CAREER PATH Worked as a broker at several

firms in New York and Chicago and was fired twice, convincing him that he needed to run his own show

BIGGEST ACCOMPLISHMENT Building a superfast stock exchange that now accounts for one-fifth of the trading volume in NASDAQ stocks

AMBITION To challenge the supremacy of the New York Stock Exchange and NASDAQ

AFTER HOURS A lifelong hunter, he still pursues deer, pheasant, and duck in the woods of Wisconsin, Louisiana, and Illinois

taught him teamwork, says Brother Richard Kestler, Putnam's principal at West Catholic High School. Kestler recalls Putnam as gifted in business classes but less stellar in Shakespeare.

After college, Putnam picked up a few bruises as he bumped around Wall Street, working for a half-dozen trading firms and getting fired by two of them. He says Oppenheimer & Co. canned him in the mid-1980s because he wasn't producing enough business to suit his bosses. And in 1992, he says, he was on the street again after he and his superiors at Prudential Financial Inc. disagreed on whether he was authorized to execute a big futures trade that he had made for a customer. That's when Putnam decided he had to go into business for himself. So he set up a firm serving day traders called Terra Nova Trading LLC. "I was pretty angry about [getting fired]," he admits. "I'd much rather be in control."

RENEGADE ROLE

WHILE CURRENT AND former associates call Putnam a fair-minded manager and team player, he has rubbed some the wrong way. Two of his former partners have filed separate suits against Putnam, claiming he froze them out of Archipelago. One, Chicago trader and financial author Lewis J. Borsellino, lambastes Putnam as a "car salesman," although he acknowledges that he's "very intelligent and very shrewd." Putnam is battling the suits and his attorney, Lori E. Iwan, says that she's confident "the truth will prevail." The NASD, the securities industry's

CUTTING EDGE Putnam charges higher fees for his high-speed trading system

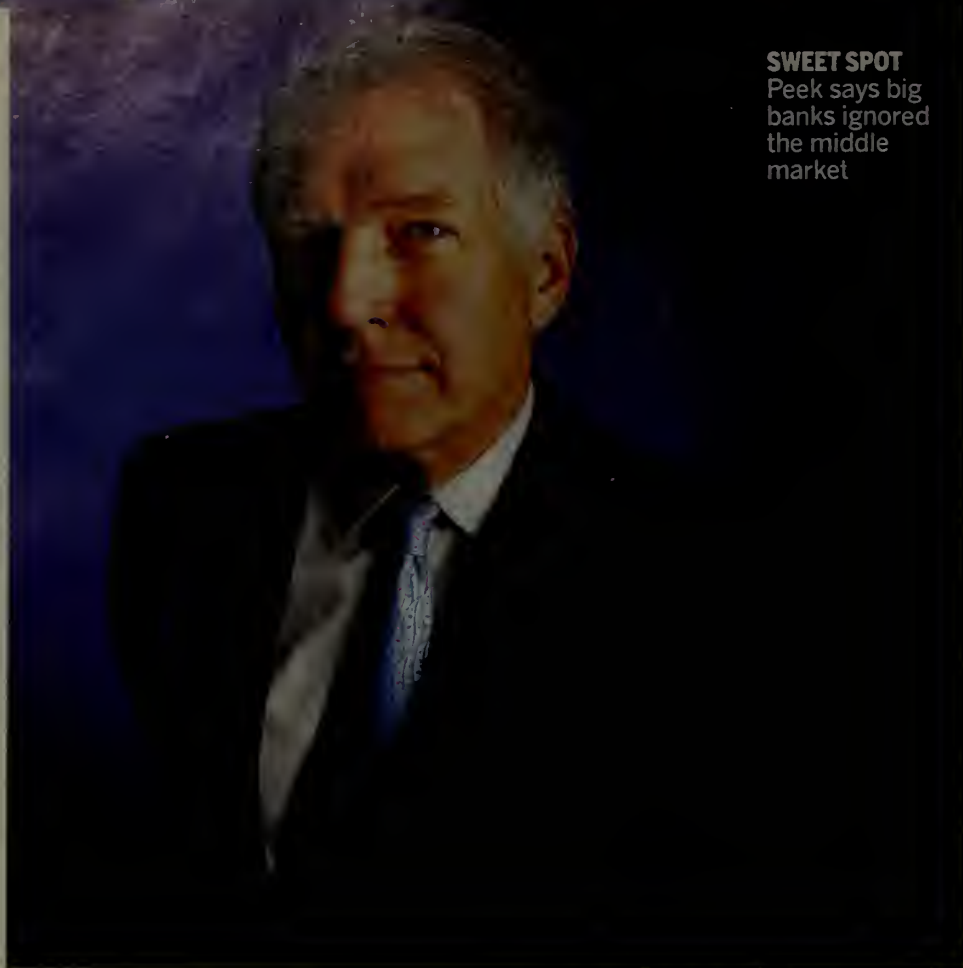
regulatory organization, once fined Putnam \$10,000 after he consented—without admitting or denying blame—to a finding that he failed to supervise staffers at his firm in 1998 who posted "exaggerated" claims about securities on a Web site that was used by day traders.

Putnam relishes his renegade role. He could retire and hunt all the deer he wanted by selling Archipelago today. The 1.2 million shares he owns are worth \$19.8 million, not counting options. But with the industry reshaping itself as electronic trading booms, he likes being at the center of the action. "He's a young, passionate guy," says Celent Communications analyst Jodi Burns. "He's in this fight to stay." Indeed, Putnam promises, "we're going to win." He's hardly humble, but his targets are hardly small, either. ■

—By Joseph Weber in Chicago

MICHAEL L. ABRAMSON

SWEET SPOT
Peek says big banks ignored the middle market



Going from Staid To Supercharged?

New CEO Peek is running CIT Group more like a Wall Street firm

AFTER NEARLY TWO decades running CIT Group, Albert R. Gamper Jr. needed a change. And so, he figured, did the firm. None of his senior managers, who averaged 17 years of service, could outline a vision for how the finance outfit should grow. Few dared to contradict him anymore. So Gamper sought new blood to take the staid, but profitable, Livingston (N.J.) company—a key player in financing small and midsize businesses—to new heights. His choice: veteran investment banker Jeffrey M. Peek, who yearned to

make his mark as a chief executive but had been rebuffed in contentious succession battles at both Merrill Lynch & Co. and Credit Suisse First Boston.

So far, the 95-year-old CIT is getting just the shakeup—and the vision—Gamper wanted. Peek, 57, who joined CIT a year ago and became CEO in July, aims to diversify the business and smooth out earnings by selling more services—such as advice on how to buy or sell businesses—to existing clients. He also

wants to ramp up the financing side of the business by acquiring smaller lending outfits worldwide and to bolster operations to satisfy customers expanding overseas. He will run CIT much like a Wall Street firm, further tying compensation to financial results, keeping a close eye on risk, and boosting fee income. “We’re going to get more aggressive,” he says. “We’re talking more productivity, fewer meetings, more time with clients, and less time at the water cooler.”

Triple-A lenders such as GE Commercial Finance Services and American International Group Inc. also serve the vast midsize market and can offer lower rates because of their greater heft. But others are fair-weather lenders, disappearing when the economy turns down. “We see an opportunity to forge greater ties to the middle market, which has been largely vacated by the big banks,” Peek says. “We are part of the fabric of these companies.”

“FAST ON THEIR FEET”

CIT’S SALES culture—which emphasized selling products over serving clients—was first to get an overhaul. CIT now gets 70% of its revenue from interest income earned on loans and leases. That should fall to 50%, says Peek, as he brings in more fee-based income from client services, such as mergers-and-acquisitions advice—his Wall Street forte. The strategy makes earnings less volatile, and clients seem game. “If he broadens the things they do, we’ll do more business with them,” says longstanding client Wilbur L. Ross Jr. (page 48), who secured \$1 billion from three lenders—including CIT—in 30 days to acquire Bethlehem Steel Corp. in May, 2003. “We find CIT is just about as fast on their feet as Goldman Sachs and UBS, and that’s pretty good,” he says.

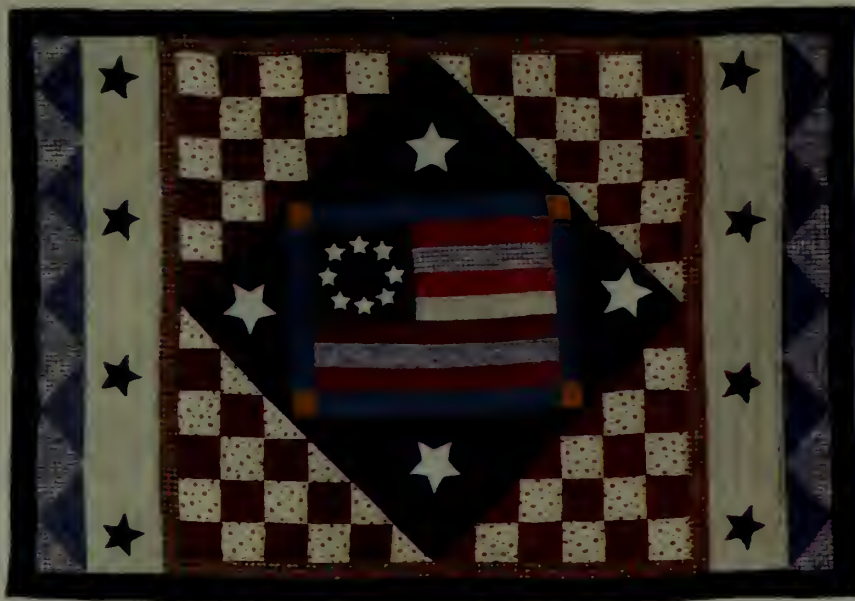
Peek has already dramatically changed the way CIT uses its capital. Historically, CIT allocated capital equally across the company, regardless of the industry each unit served. Now it spreads it according to risk, which tempers its overall exposure. “That’s another benefit that comes from Peek’s experience on the outside,”

says David Hochstim, financial-services analyst at Bear, Stearns & Co.

There’s some reengineering in the works, too. Peek promises to cut the company’s \$1 billion in annual op-



VETERAN Former CEO Gamper went outside for new blood and vision



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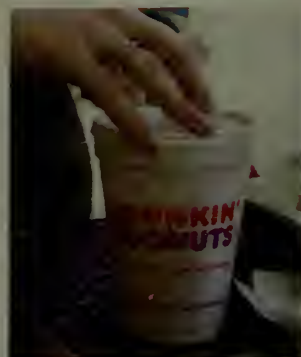
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Big Loans, Midsize Clients



DUNKIN' DONUTS One of CIT's oldest clients gets franchise financing



BETHLEHEM STEEL CIT helped underwrite a \$1 billion loan for a buyout



ECKO ENTERPRISES The private label has a \$100 million revolving loan

erating expenses by as much as 7.5%. The market likes what it sees: The stock has doubled since it went public in July, 2002, prompting Standard & Poor's to put it in the S&P 500-stock index on Oct. 26.

Much more than Gamper, Peek has set his sights on expanding overseas. He added to the company's London staff to build up the European lending and corporate finance business. He's also leasing more jets to growing European airlines, avoiding the embattled U.S. airline market. And he has cut costs by consolidating back-office operations in Dublin. Eventually, he'll expand in Asia, where many of CIT's textile and manufacturing clients operate factories.

Peek will pep up organic growth with acquisitions. Expect him to buy companies with \$500 million to \$1 billion of assets every few months. In a year, he has bought GATX Corp. of Tampa's equipment-leasing accounts and Citigroup's CitiCapital in Britain. Purchases from HSBC Holdings and GE boosted accounts-receivable income. Peek is selling assets, too: Gone is CIT's money-losing venture-capital portfolio, which he sold for \$90 million after taking a \$30 million loss. CIT's \$150 million in private-equity investments could be next.

STAR POWER

HEADING UP CIT is sweet success for Peek, who has long wished to run his own show. A Midwesterner and Harvard MBA grad who spent 18 years at Merrill, Peek lost to Stanley O'Neal in a succession battle to head the huge brokerage in 2001. Barry Friedberg—who not only gave Peek his first Wall Street job in 1975 at AG Becker but was also his boss for a decade after Merrill bought the firm in 1983—says Peek had star power from the start.

Peek ran the financial institution group, the largest segment of Merrill's investment banking operations, at a time when this part of Merrill's business was growing rapidly. "What was accomplished during those years was very important to Merrill's growth," says Friedberg. "For all that Jeff has accomplished, he has got a very understated and balanced ego."

After the tussle over Merrill's top spot, Credit Suisse First Boston CEO John Mack recruited Peek to help fix the bank's regulatory problems and declining profits. Again, Peek hoped to be Mack's heir apparent. "CSFB had every problem in the book," says Mack, now a consultant for hedge-fund firm Pequot Capital Management. "But he did a lot of pulling people together. Jeff understands what you

A Peek At CIT

The firm's new CEO, Jeff Peek, is revving up growth at the specialist lender by:

FINANCING MORE COMPANIES in fast-growing sectors, such as technology and health care; providing more financing to private-equity funds

BEEFING UP BUSINESSES that generate fees, such as mergers-and-acquisitions advice; persuading customers to buy a range of services, not just one or two

BUYING SMALLER FINANCE COMPANIES with \$500 million to \$1 billion in assets to bulk up its loan portfolio

EXPANDING ABROAD by investing in existing operations and making acquisitions in Europe and Asia

have to do to change an organization." CSFB's troubles, however, ran so deep that the best Peek could do, being the investment banker he is, was to sell its most profitable asset to raise cash. Peek brokered the \$2 billion sale of CSFB's securities clearing unit, Pershing, to the Bank of New York in February, 2003. By then, Peek and Gamper had begun to talk.

After Gamper named Peek as his successor five months later, the inevitable rumors flew. Did Peek's arrival mean Gamper was gunning to sell CIT—again? In 21 years, Gamper courted owners from Japan's Dai-Ichi Kangyo Bank to infamous Tyco International CEO Dennis Kozlowski, who paid \$9.5 billion for CIT in 2001. Tyco spun it off soon after the Koz's fall from grace in a \$4.6 billion initial public offering—CIT's second in five years. "Give me a break," says Gamper, 61, about the scuttlebutt. "Who sells this company better than I do? I've sold it to the Japanese, the Polish, and the public. I don't need an investment banker." Gamper will become full-time chairman of the Board of Governors at Rutgers University in December.

STAYING INDEPENDENT

IN ONE OF THE better executed successions in recent Corporate America history, Gamper passed to Peek a stable company he grew from \$7.9 billion to \$52 billion in assets. He salvaged CIT after its near-death experience under Tyco—a cash crunch that sunk its credit ratings and drove its borrowing costs sky-high. "A few years ago, they were in a situation where they couldn't charge enough to make money," says Hochstim. "The CIT of today is in much, much better shape than the one that was bought by Tyco."

In fact, on Oct. 21, CIT reported that third-quarter earnings rose 24% from a year ago, the sixth straight quarter of increasing profits. And new business volume has grown by \$6 billion, or 10%, since last year. Margins are improving and credit losses are at a three-year low.

Still, one of Peek's challenges will be to keep CIT independent. Its ties to the volatile airline industry could spell trouble. If a large carrier liquidates, leasing rates could plummet, hitting CIT with losses. Worse, warns Bear Stearns's Hochstim, "In another downturn, the financial markets could get nervous again and CIT's funding costs could spike." That might open the door for a suitor to swoop in. If so, CIT will already have an investment banker on the payroll. ■

—By Mara Der Hovanesian
in Livingston, N.J.

Data: BusinessWeek



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Big Bucks from Bubble Fears

Manager Peter Thiel sees a correction ahead—and that has helped him clean up

THE FINANCE INDUSTRY has been very good to Peter A. Thiel. The 37-year-old president of \$270 million hedge fund Clarium Capital Management LLC started as a derivatives trader at Credit Suisse Group in 1993. He made enough money to head west in 1996 and launch a venture-capital fund that backed an Internet payment system called PayPal. When eBay Inc. bought PayPal in 2002, he walked away with \$46 million in stock. Now, Thiel is getting richer by betting against a finance industry that made him rich. "It may be ironic, but that doesn't mean it's wrong," he says.

The way Thiel sees it, the tech bubble of the 1990s never completely popped. It simply mutated into a finance bubble. "Half the profits in the Standard & Poor's 500 come from financial services today," he says. "That's clearly unsustainable." For three years, consumer spending has propped up the U.S. economy, thanks to low interest rates and ever more creative forms of borrowing, he says. He believes that the trend reached an absurd apex with the recent rise of credit cards linked to home-equity lines of credit. Now, with outsize consumer debt and a housing market that's a bubble, he thinks a major market correction is at hand.

Thiel's strategy is simple: He's shorting some indexes that are heavily weighted with financial-services stocks. Thiel also dislikes General Electric Co., with its huge finance arm, and Wal-Mart Stores Inc. Both rely on debt-fueled consumer spending, he argues, yet the risk isn't reflected in their price-earnings ratios, which are far higher than most of their

BLUE PERIOD

Thiel has made good use of his dismal scenario



Profits of Doom

Hedge-fund operator Thiel sees much tougher times ahead. Here's his forecast and how he's placing his bets:

PROBLEM	STRATEGY
Looming deflation	Buy long bonds
Ballooning U.S. current-account deficit	Short the U.S. dollar
Bursting housing bubble	Short financial stocks

Data: Clarium Capital Management

peers. "They're the bubble stocks of today," he says.

That's not all. Once the housing bubble bursts, he argues, consumer spending will plunge, leading to deflation. That will affect investments beyond financial stocks. So Thiel has been shorting the

U.S. dollar while betting oil will stay high.

Think what you will about his bleak scenario, Thiel is cleaning up. Since its inception in October, 2002, San Francisco-based Clarium's hedge fund is up 146%, far outpacing the 16.6% gain in the Van Global Macro Hedge Fund Index, which tracks similar funds.

CONTROVERSIAL AUTHOR

NOT EVERYONE ACCEPTS Thiel's views. Tobin Smith, founder and chairman of ChangeWave Research, an investment research firm in Rockville, Md., says that in a bubble, people purchase homes just to rent them out. That isn't happening now. "Until you have an area where there's more than 20% buy-to-let, I don't buy [that there's a bubble]," he says.

Last winter, Thiel almost plunged into one of the nation's hottest housing markets. He was negotiating to buy Martha Stewart's Manhattan duplex condo priced at around \$7 million. In the end, he backed out. "I'm constantly talking about a real estate bubble. I shouldn't be buying a place," he says. In San Francisco, Thiel, who is single, owns a downtown penthouse where he regularly hosts salons featuring such guests as Nobel economist Milton Friedman.

Thiel has never shied from controversy. After graduating from Stanford Law School in 1992, he co-authored *The Diversity Myth*, a book that blasted multiculturalism at Stanford University. His view drew a sharp rebuttal from then-Stanford Provost Constance Rice. A libertarian, Thiel advises several free market think tanks, including the Pacific Research Institute in San Francisco. "He believes in open markets and that self-interest can be harnessed in useful and productive ways," says Sonia Arrison, the institute's

director of technology studies.

So far, self-interest has paid off for Clarium. Thiel and his staff collect a 25% management fee tied to the fund's performance. As long as the financial sector loses, they'll win. ■

—By Justin Hibbard in San Mateo, Calif.

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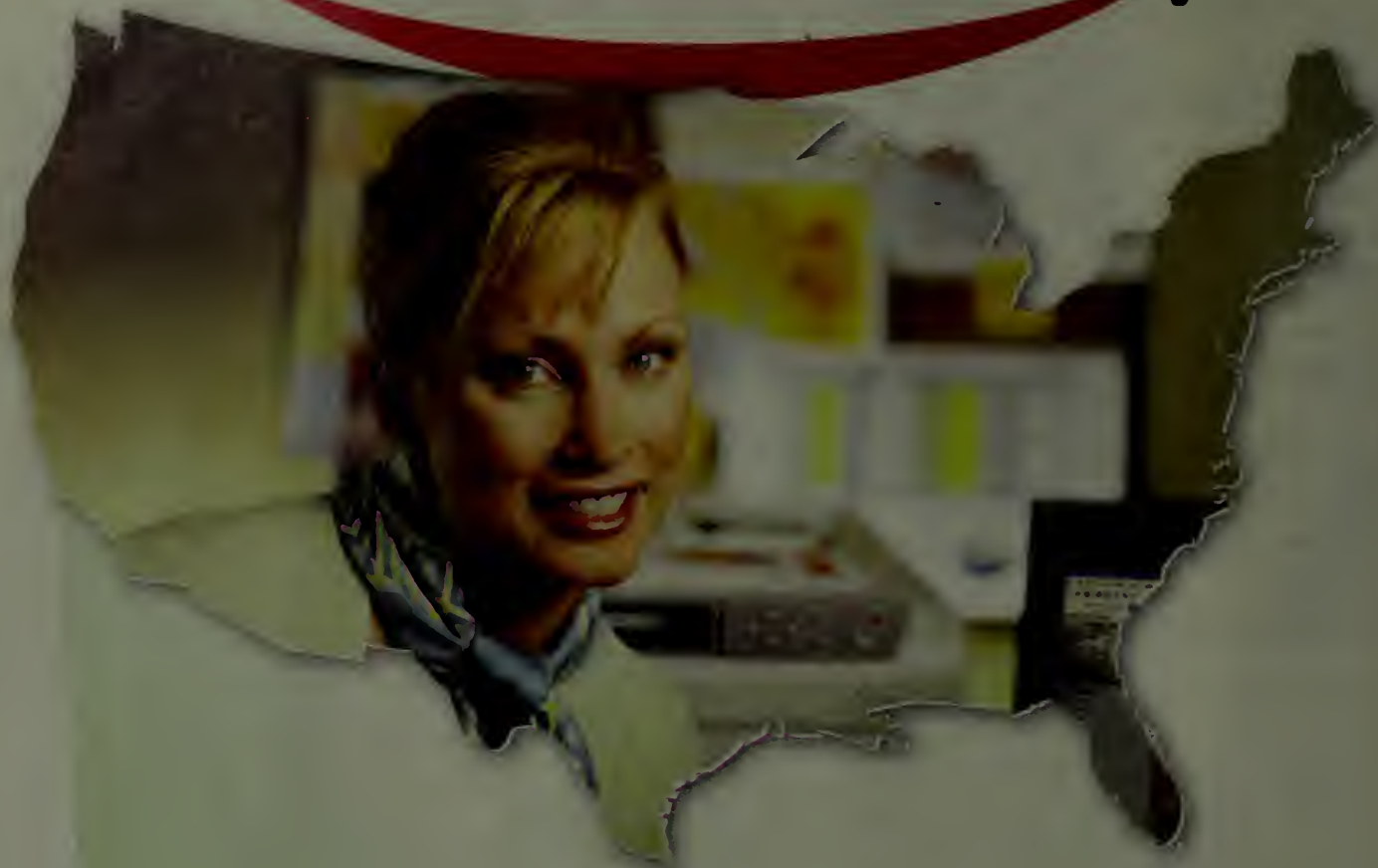
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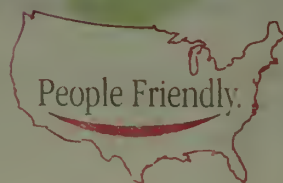
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PHONE MAGIC

With today's cell phones, you can catch the news, shoot videos, listen to music, and more. **By Roger O. Crockett**

HIP-HOP IMPRESARIO Russell Simmons took one look at the Motorola Razr V3 mobile phone and declared it "hot." After all, at half an inch thin and just 3.35 oz.—with the look of a classic straight-edge razor—the Razr is, well, quite sharp. But what's most remarkable about this svelte pocket pleaser is that it squeezes a video-clip player, zoom camera, and polyphonic speakers into a matchbook-thin frame no wider than a credit card. "Just like a cool pair of sneakers or a watch, a phone says something about who you are," says Simmons in an e-mail. "But it's got to be functional to be in the game."

The days when a mobile phone was just for gabbing are long gone. Years ago, they started handling short text messages and (slowly) browsing the Web. Last year was the coming-out party for starter camera-phones. And this year? Get ready for what amounts to mini digital-entertainment centers that simply masquerade as mobile phones. Watch snippets of ABC

News or Fox Sports on vivid color LCD screens. Listen to National Public Radio or any other radio broadcast. Shoot video clips of the kids' weekend soccer games. Snap digital photos that rival those from your digital camera. You can even fire up your favorite Rolling Stones MP3 and listen in slammin' stereo sound.

These goodies don't come cheap, though. This year, for the first time in recent memory, average phone prices are actually going up. You can still buy a decent phone with a color screen and low-end camera, for \$50 or even get one free, if you sign a service agreement. But the full-featured models hot off the assembly line can cost as much as a PC—up to \$799 for Motorola's Razr. So a word to the wise: Use the Web to shop for the best prices. Sites such as Amazon.com and LetsTalk.com let you compare prices from a variety of sources. Discounts can be substantial. The Razr drops to \$499 with a two-year service agreement. Prices quoted here are with two-year contracts, unless otherwise noted.

I have two favorites among this new

crop of phones: the Razr and Sony Ericsson's S710a. The Razr is simply the flashiest phone around. Even its keypad, made of a flat sheet of magnesium, has distinctive style. It's also good for music, video, and games. With its crisp screen, the Motorola phone got me hooked on playing the puzzle game *Bejeweled* as I rode the bus to work.

Sax Appeal

SONY ERICSSON'S \$399 phone isn't quite as winsome, but it does simply everything. Plug in headphones, and you get full-fledged FM radio with killer reception. The sound is so good that jazz enthusiasts will be able to discern the hushed reed whispers in John Coltrane's tenor sax. The phone's camera is 1.3-megapixels with an 8X digital zoom, much better than others on the market. I zoomed in tight on the engine of a car I'm trying to sell that you could see the brand name on the spark plugs. And it shoots reasonably high-quality video clips. I used it at the Ruffled Feathers Golf Club in Lemont, Ill., to let my bud-



RAZR V3 Motorola's straight-edge look-alike has miniature polyphonic speakers

PHONES > CELLULAR

dy, Billy, see how he could lengthen his backswing.

There's one caveat for both these phones, however: You can get them only from Cingular, at least for the next several weeks. The company cut unusual, exclusive deals with Motorola and Sony Ericsson to kick off its acquisition of AT&T Wireless. T-Mobile will probably get both phones early next year, while Verizon Wireless, Sprint, and Nextel may have to wait longer, since they use different wireless technologies. The broader point is important: Certain phones are available only from specific carriers.

Of course, most people don't want to spend hundreds of dollars for a mobile phone anyway. Never fear. You can still get many of the new capabilities at more reasonable prices, but you need to decide which features are most important for you. Listening to music on your phone? Watching news clips? Taking video?

In the Picture

IF YOU'RE LOOKING for a good camera-phone, there are loads of choices. This year's models are a big step up from the first grainy camera-phones, and they don't cost a fortune. One good option is the Samsung MM-A700, a flip phone with a large screen that goes for \$200. Motorola's V710 flip phone is another solid choice for less than \$150. And of particular note is the Nokia 6620. It's a brushed-silver model with the same candy bar design—albeit wider, more like a Kit Kat than a Snickers—that made the Finnish phonemaker famous. The \$150 phone lacks a flash, but it does have a nifty self-timer, which you can set for 10, 20, or 30 seconds—just enough to let you jump in the shot with your friend.



POWER TOOL

SONY ERICSSON AKONO HEADSET HBH 660
\$135 / SONY ERICSSON
SONYERICSSON.COM

Many companies make Bluetooth headsets, cutting the cord between you and your cell phone. But the clever Akono HBH 660 has caller ID built into the earpiece. If your phone is in your pocket or briefcase, you can peek at the headset display to see your caller's name or number. Answer—if you want—by tapping a button.

Want to shoot video clips of your kid's birthday party? If you aren't inclined to dish out the big bucks for the Sony Ericsson S710a, there are some reasonable alternatives. The LG VX7000, which goes for \$199, shoots good-quality clips and boasts a flash and rotating lens. And the Toshiba VM4050, available for less than \$200, has a super-bright, high-quality screen. Still, keep your expectations for video phones in check. Phones with video now are like camera-phones last year—more interesting novelties than satisfying substitutes.

Music phones are another matter. Several models can store a dozen or more high-quality MP3s. They're hardly encroaching on the iPod's turf, but these phones are becoming a threat to low-end portable music players. Among the best are the Siemens SX1, the Nokia 3300, and Motorola's e398. The \$200 Motorola phone boasts awesome acoustics

and enough memory to hold several dozen songs.

A good screen makes a world of difference when it comes to mobile multimedia. That's especially true for gamers and those brave enough to try tuning in to television shows on their phones. (page 150). To get the best experience playing *iRobot* or *Family Feud*, look for phones like Samsung's MM-A700 or Sony Ericsson's S710a that have 262,000 colors. That's a big improvement from the 65,000 colors available on last year's best phones, although it's still far short of the 6.5 million standard on today's top TVs. Size matters, too: Nokia's 6620 has an extra-large, 2.25-inch screen, measured diagonally.

Finally, take a tip from Russell Simmons: Never neglect style. No longer just phones, these gizmos are Hollywood on your hip. From music to videos to making calls, they have it all. ■

BEYOND VOICE

This season's new phones do much more than let you talk. They're cameras and music players and game machines, all rolled into one.

PHONE	PRICE	CARRIER	THE GOOD, THE BAD, THE BOTTOM LINE
SAMSUNG MM-A700	\$199*	Sprint	The Samsung can display top-notch streaming video and boasts a camera with flash. But there's no Bluetooth or speakerphone >>
NOKIA 6620	99 - 249*	AT&T Wireless, Cingular	Not the sexiest design, but plenty of high-end features, including camera, speakerphone, Bluetooth, and an infrared port. But battery life is disappointing
MOTOROLA V3 RAZR	499*	Cingular	This sleek phone packs a high-resolution display and camera into a wafer-thin flip. The shiny keypad is almost too slick, it's pricey—but it's ultra-cool
SONY ERICSSON S710a	399*	Cingular	It's a bit bulky and the huge screen is always exposed, but so what? The swivel design is cutting-edge, changing the S710a from camera to phone with the flick of the wrist >>
NEXTEL i860	179-199*	Nextel	Nextel finally has a camera phone, made by Motorola. It's extending its signature walkie-talkie service so that friends in Canada and Latin America are a click away

c|net



*Carriers may require activation. Prices subject to change without notice. See carrier agreements.

Data: N

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YES, YOU CAN TALK, TOO

Wireless data services have come a long way fast. Here's a quick tour of what's available. **By Roger O. Crockett**

YOU STUMBLE ACROSS IT when you're fiddling with your cell phone. Click, click, click. And then there it is, like the door to a mysterious, unknown land. It may have a name like "Web" or "browser." Maybe, once or twice, you even took a few steps into this foreign territory. But then you got lost or frustrated with how long it took to get anywhere. Or perhaps you became concerned with what you were going to get charged for the Weather Channel's extended forecast for your town. After all, why use your cell phone when you could just look in today's newspaper?

Okay, forget the paper for a moment. Time for a guided tour of the data services you can get on your mobile phone. It's worth a few minutes of effort. Today more

than ever, cellular carriers are offering up a variety of useful—and downright fun—wireless extras. There are ring tones and mobile games, picture-mail and Web browsing, even television clips and what are known as location services. The latter lets you find things like what street a co-worker is standing on and whether there's a Starbucks nearby where the two of you can meet.

The possibilities this new technology creates are intriguing. Take it from Chris Butler, a 24-year-old tech consultant in Chicago. He's upgraded the caller ID function on his Sanyo 8200 from Sprint with photos of people that call him. His girlfriend dials his number, and up pops her picture. He can download music clips to turn his phone into a personalized alarm clock when he's on the road. His cell phone lets him watch CNN highlights

LOOK AND LISTEN
Butler's girlfriend
calls him—and
up pops her picture

while riding to the airport in a taxi. And soon, Butler and most anyone else will be able to equip their phones with "ringback" tones—music that a caller hears when your phone is ringing or when she is on hold. "[Cell phones] are so much better than a couple years back," Butler says. "[Then] I just wanted my battery to last more than an hour."

Dabbling with these data services won't break the bank. Most of the carriers offer packages that allow you to explore the world of data for a reasonable monthly fee. Look for plans that mimic the flat fee packages of voice minutes you're familiar with. Sprint, for example, offers unlimited picture- and video-mailing, Net browsing, and text messaging for \$20 a month, on top of your voice plan. If you don't need unlimited amounts, or you only want one type of service—photos rather than music or videos—the carriers offer lower monthly plans. For Net browsing with photo messaging alone, it's \$15 at Sprint. AT&T has a \$7.99 plan—its most popular—for a megabyte's worth of data. That's enough to send about 25 decent-quality photos a month.

While every carrier now offers plans to launch you into the data world, some are better than others. My favorite is AT&T. It has a wide range of packages, starting at a very reasonable \$2.99 a month for its "mini" plan and topping out at \$24.99 for a plan that gives you unlimited access to a broad range of goodies. Sprint, Verizon, and T-Mobile also offer reasonable plans, although I found them slightly harder to use or short on particular features. Cingular is the least attractive option. It typically offers small allotments of things like text messages or Net access and you pay extra if you use more. Its unlimited data packages are pricey. The rub is that Cingular is acquiring AT&T, in a deal expected to be completed this year. Cingular's voice service is much better than AT&T's, but it would be wise for the giant to adopt some of AT&T's best practices when it comes to data.

Nickels and Dimes

THERE'S ONE THING to look out for with data services: The packages you get from wireless companies don't include everything. To snack on cool morsels like ring tones and games, you'll have to pay à la carte. The cost for downloading a music sound bite, for example, ranges from 99¢ to \$2.99. Games run as high as \$6.49. Each of the major carriers allows you to download some of these items

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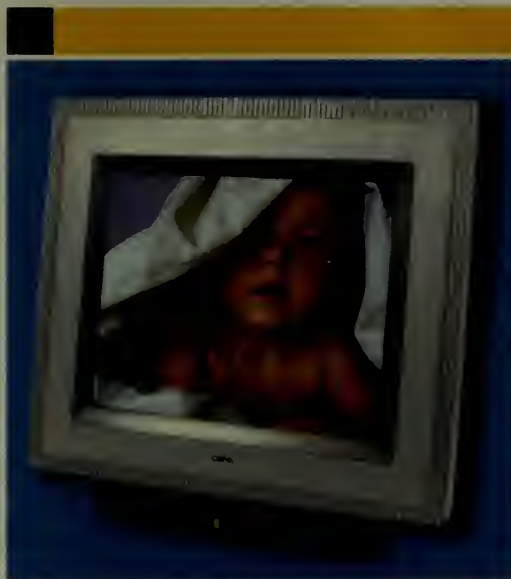
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the World.

from their Web sites. If what they offer is not to your liking you can find a wider variety of content elsewhere on the Web. Zingy.com and jamdat.com sell everything from music to games to wallpaper for prettifying up the screen on your phone. Just order what you want from a PC and send it to your phone or, with a little more effort, you can order directly from your phone.

Snapping and sending pictures just might be the most useful new tool going. Matt Walbruch, a 27-year-old real estate agent in Denver, tours 10 houses a day. He shoots as he walks through them, and then he sends the pictures to his best prospects. It's easy because his phone maker, Sanyo, has tied the camera function directly to the address book. Shoot, add an e-mail address, and send. Or take Butler, who admits that he's a bit extreme. To avoid bringing home the wrong purchase, he e-mails his girlfriend snapshots of grocery items at the supermarket and waits for her A-O.K. before he goes through the checkout line. If you're not such an avid shutterbug, nix a monthly fee and pay the 25¢ to 40¢ a photo.

TV to Go

WHILE PHOTO SERVICES are catching on, television on phones is still a work in progress. The quality of mobile TV now leaves a lot to be desired. And it's not just because you're watching on a tiny screen. The signals chug along at a rate of 15 frames per second, vs. the 30 frames for regular TV. Still, AT&T and Sprint are offering services that may tempt a few sports or news junkies. For \$9.95 a month, customers can tune in to more than 20 news, sports, and entertainment channels. For another \$4.95 a month, they can get clips from several channels, including ABC News. And im-



provements are on the way. Texas Instruments says it has developed a computer chip that will let cellular phones pick up any television broadcast in real time by 2006.

In some ways, the future is already here. Carriers such as Nextel and AT&T have tracking services that link mobile phones to satellites, which can pinpoint the location of a place or person. You need a phone equipped with global positioning system technology, but that's standard in many phones these days. The service lets users, say, find the location of a movie theater in a town they're visiting. You don't need to punch in a ZIP code: Simply click on the location-services feature, and a list of nearby eating establishments and theaters will automatically appear.

Press another key or two and it's like launching a virtual secretary. As part of AT&T's \$7.99 monthly data plan, you can punch in other AT&T users' mobile numbers and it will tell you the intersection where they are. If you want to meet some-

POWER TOOL

CEIVAMOBILE

\$10 MO. / CEIVA LOGIC / CEIVA.COM

You can now zap pictures of the kids directly from your camera-phone to a high-tech picture frame on Grandma's nightstand with Ceiva Logic's new cell-phone service. You e-mail your snapshots to Ceiva, and the \$150 frame dials in nightly looking for new pictures. It can show up to 30 in a continuous slide show on the vivid 5-in.-by-7-in. LCD.

one, the service will show you a list of nearby places—from coffee shops to libraries. Then you can call or zap a text message to that person with the address and directions.

Of course, there are privacy concerns with such a service, and carriers have taken steps to address them. You can only track someone down if that user gives you permission by including you in a list of "buddies" granted such privileges. Another limitation: You can only track down people who are using the same wireless carrier that you are. That's a nuisance that wireless carriers are working to overcome in the near future.

Slowly but surely, the carriers sense they can capture your loyalty only if they let you communicate broadly. Consider the instant-messaging services from AOL, Yahoo!, and MSN. Now you can communicate with other members when you're away from your desktop, zapping messages to their phone or computer from the bus or the ball game. Prices are generally the same as for basic text messages—usually 5¢ to 10¢ one way. And while not every carrier does it, AT&T and Sprint allow you to send instant messages to customers of all three major IM services.

By now it should be clear. Plain old telephone service is a relic of the past. A song—like a picture or a text message—can be worth a thousand words. Chris Butler's phone, a 21st century jukebox, plays *Let's Get it Started* by hip-hop group Black Eyed Peas one moment and *Baby Boy*, by R&B diva Beyoncé, another. He has a different ring tone for each of his buddies. "I know who's calling before I pull the phone out of my pocket," he says. With attractions like musical caller ID, it may be time to consider a visit to the world of wireless data. ■

EXTRAS APLENTY

Mobile carriers offer a bundle of multimedia services—sports, weather, Net browsing—for a monthly lump sum. After that, it's à la carte.

RINGTONES New phones come with generic music to signal an incoming call, but you can download snippets of Rolling Stones or Beyoncé songs for 99¢ to \$2.99 per tune

GAMES While such classics as Pac-Man can be free, new games, multiplayer games, and monthly subscription games from the carrier or gamer Web sites cost \$2.99 to \$6.49

PICTURES The cheapest way to get photo and video messaging is as part of a monthly plan, such as Sprint's \$20 deal for both, or you can pay by the snapshot, 25¢ to 40¢ each

TEXT & INSTANT MESSAGES It costs 5¢ or 10¢ to send and sometimes receive a text message, or instant message via AOL, Yahoo!, or MSN. But they all have message buckets for a monthly fee

STREAMING MEDIA Live radio broadcasts or TV feeds rarely come as part of a package. Expect to pay \$4.95 to \$9.95 a month

THUMBTHING FOR EVERYONE

The three hottest new handhelds: Which one is right for your mobile messaging needs? **By Stephen Baker**

THUMBS. FOR CENTURIES, they have conveyed the simplest of messages. Up/down, good/bad, salvation/lion chow. But look at the folks in the elevators, the checkout lines, even crawling along in traffic jams. They're tapping madly with thumbs on the tiny keyboards of wireless gizmos. The other eight digits—who needs 'em? For digital nomads, this trend promises to lighten the load. It just might be time to leave the laptop at home and to trust in a pocket-size smart phone and a pair of typing thumbs.

The options have never been richer. For the past three years, the Treo, the RIM Blackberry, and a youth-oriented gadget called the Sidekick have sparked much of the mobile messaging excitement in the U.S. market. All three are now launching enhanced models. While other options continue to pop up, most shoppers are likely to end up weighing these three alternatives. So how about an old-fashioned bake-off? We've picked up these three, banged out some messages, tried some wireless Web surfing, even made a few old-fashioned phone calls. Now it's just a matter of picking a winner.

It doesn't take long to spot the turf each of these machines is staking out. PalmOne's new Treo 650 is for mobile digerati who want just about everything. It has a snazzy camera and a touchscreen. Plug in a memory card and you have an MP3 player that can hold some 300 songs. The slimmer Blackberry 7100T feels much more like a normal phone than the other two—but one with a highly innovative and peculiar keyboard. And T-Mobile's Sidekick II, far less geared to-

ward corporate use, is suited to a generation that lives on instant chat and wants to do it everywhere.

Word Search

THESE GADGETS ARE A GAS, but for big cell-phone yakkers, a word of caution: They are not terrific talking machines. If you're used to a late-model cell phone, these hybrids can feel like a three-year step back in time. Why? They're carrying a lot of other baggage, including keyboards. The bet is that the rich, non-talking features will more than compensate for extra bulk in the handset, the lower battery life, the struggle to figure out where to put your ear. But if what you want is first and foremost a phone, take a tough test drive before committing.

The boldest innovation arrives in the

latest Blackberry, the slender 7100T. Priced at \$199 from T-Mobile, with a \$59.99 monthly subscription that provides limitless data and 1,000 minutes of talk time, this gadget is targeted more toward consumers than Blackberry's traditional corporate market. It looks more like a phone than an e-mail machine. And at first glance it doesn't appear to have a keyboard. Take another look, though, and you see that the entire alphabet is crammed onto just 14 keys.

How to write on a setup where two letters share the same key? You simply type the English words and sentences you're thinking of, and the Blackberry's software divines what you're trying to say and picks the appropriate letters. This system is wickedly smart and usually gets it right. It appears to understand not only the vocabulary but also the context within a sentence. If the system guesses wrong, it provides the other possibilities and lets you pick the right one. Trouble is, you still end up arbitrating quite a few of these disputes. For foreign names and passwords, the easiest route is to bypass the word-guessing software, and to tap each key one, two, or three times for the appropriate letter or number. That's when you wish every one had its own key.

I marveled at this Blackberry's technology but still found it a grind to type. The upshot? It's a good gadget for those who want to monitor e-mail on the run and are happy to send back short and sweet replies. Beyond e-mail, this Blackberry boasts a bright color screen, but little fun: no camera, no music. It does offer instant messaging—though it would require nothing short of a thumb-typing



POWER TOOL

AT&T WIRELESS OGO
\$99/ATTWIRELESS.COM

This affordable fliptop with a full keyboard and a color screen is targeted at young instant-messaging addicts. Ogo lets the chat session carry on, right out the door and into the street. It handles e-mail as well, but not phone calls. The \$18-per-month subscription includes a link to one instant-messaging service. Connections to others and to POP mail accounts cost an extra \$3 each.

TALK AND TYPE

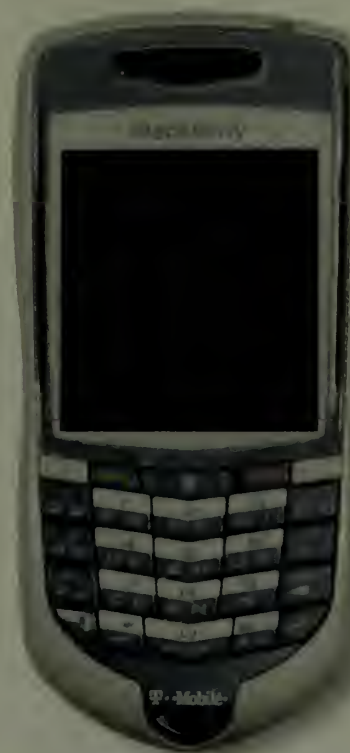
Here's a look at how the latest phone and e-mail devices stack up:



#1 PALMONE TREO 650

TOP ALL-ROUND E-MAIL PHONE
PRICE: **ESTIMATED \$499***

- Bright touchscreen
- Can edit Word and Excel attachments
- New camera blows away earlier versions
- Plug in a flash memory card, and it's a 1 gigabyte MP3 player



#2 RIM BLACKBERRY 7100T

GOOD PHONE BUT TOUGH TYPING
PRICE: **\$199.99***

- The lightest of the three: At 4.6 oz., it feels most like a cell phone
- Innovative keyboard: Software figures out which letter you want
- Trackwheel makes for simple navigation



#3 T-MOBILE SIDEKICK II

CLUNKY PHONE, GREAT KEYBOARD
PRICE: **\$249.99***

- By far the best keyboard
- Camera can't store many pix
- Instant chat is a breeze
- Screen colors are dull
- A youth gadget without an MP3 player!?

*With one-year service plan

whiz to carry out a running chat on the condensed keyboard.

Devoted mobile typists should consider T-Mobile's Sidekick II. With its throw-back look of a *Star Trek* relic, it has a screen that swivels onto its side. This opens onto one of the best keyboards in the handheld universe. Chat on the \$249.99 Sidekick is a breeze. E-mails can run into paragraphs. Snap a picture with its camera, and it's a cinch to send it along in a message. A T-Mobile \$59.99 monthly subscription provides limitless data and 600 minutes of talk time.

An Achilles' Heel

BUT TALK IS the Sidekick II's Achilles' heel. Its patchy voice quality ranks a clear third in this bake-off. Users are likely to find it awkward for the spoken word. What's more, Sidekick II does not plug into corporate e-mail as easily as its competitors. Think of it as a leisure device.

But for kicking back, this machine is missing one crucial piece: an MP3 player. Here's betting that if there's ever a Sidekick III, it'll come with vibes.

That brings us to the winning entry, PalmOne's Treo 650. This handset, likely to be priced at \$499 with monthly service plans in the range of \$60 when launched in November, blends the strengths of its two competitors. It syncs with corporate systems as neatly as the BlackBerry. But like the Sidekick II, it boasts a full keyboard—albeit with maddeningly tiny keys. As a phone, it performs a tad better than the smaller BlackBerry. And its touchscreen and popular Palm interface combine to make it the easiest to navigate. This new version has a doozy of a camera: The detail in its photos blows away not only the Sidekick II but also the one-year-old Treo 600 (which will likely remain on the market at around \$200).

What's not to like? Sad to say, the In-

ternet. Each of these handsets boasts a Web browser and links to popular sites, such as Yahoo! and Google. But the connections remain frustratingly slow, with lots of clicking and waiting. Coverage blinks out under bridges or around a street corner. Fact is, while mobile e-mail works, the mobile Web—at least in the U.S. market—remains a work in progress.

Still, even those who handle e-mails the old-fashioned way will likely be tapping away with their thumbs before long. Why so? Corporations the world over are eager to get these productivity machines into employees' hands. The Yankee Group estimates that of 35 million mobile professionals in the U.S., only a vanguard of 2 million use mobile e-mail. Yankee expects this number to soar. As it does, chances are you'll soon be getting one of these cool e-mailing tools, courtesy of your boss. Time to limber up those thumbs. ■

Middleware is Everywhere.

Can you see it?

4

3

5



DB2.**Key**

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**IBM**



REVIEW By Steve Rosenbush

NET CALLS: THERE'S LOTS TO LIKE

YOU SEE THE ADS EVERYWHERE these days—on the subway, on the bus, and on billboards. One screams that you can get unlimited local and long-distance telephone calls for just \$29.95. Other come-ons offer the same deal for \$24.95 or even \$19.95. How can they do it? The companies offering these phone services use super-efficient Internet technology. Then they throw in extra goodies such as voice mail for free. The result: bargains that can cost less than half the price of traditional phone service.

Yes, it's a great deal. But you have to be willing to put some work into mastering the technology. If using a regular phone is as simple as operating a toaster, then Net phone service is more like programming the remote control for your home entertainment system. I learned that the hard way when I tested four leading Internet telephone services from such established players as AT&T and little-known upstarts such as 8X8 and Skype.

My favorite, by far, was Skype. The service, offered by London-based Skype Technologies, is a little different from other Net phone offerings, which require you

to plug in wires and hardware into a broadband Web connection. Skype is just software that you download from the Web for free. And you don't need any extra gear beyond an Internet connection and a computer equipped with a microphone and speaker. You can call millions of oth-

GOOD TO SEE YOU Packet8's videophone service costs an extra \$10 a month, plus \$300 for the phone after rebates



er Skype users around the world for free just by clicking on a name on your computer screen. And you can place a call from your computer to any regular phone for about 2¢ a minute. Voice quality was good, though conversations occasionally become garbled.

If you want a service with better sound, you have to pay a bit more. One

good choice is 8X8's Packet8. The price, \$19.95 a month, is hard to beat. Installation is a breeze, and sound quality is very good. You can even get videophone service for an extra \$10 a month, though the videophone itself will set you back \$300 after rebates. The hitch? Packet8's Web site is a clunker—you can't listen to voice mail online.

Odd Sites

IT'S PUZZLING that some Internet telecom companies don't seem to have paid too much attention to their Web sites. After all, their customers are, by definition, Net savvy and likely want to use an online site to pay bills or check their voice mail.

Here, Vonage Holdings is the pacesetter. The company has a cleanly organized Web site, and it was a breeze for me to pick up my voice mail online. Vonage is also moderately priced, at \$24.99. The only drawback was that Vonage's Web site once launched my iTunes software and played Waylon Jennings' *Big Ball in Cowtown*.

Voice mail on the Web is just the start. The features that come with Net phone service can put your traditional phone to shame. I was particularly impressed with the extras from AT&T's CallVantage, though it is pricier than its rivals, at \$29.99. CallVantage lets you create 10-person conference calls or set up a service that tracks you down at all of your phone numbers.

Overall, I was pleasantly surprised by my experience. Sure, there are a few disappointing aspects. Some Internet phone services can crash when your electrical power or broadband line goes down, and not all of them can handle 911 emergency calls. Still, Web phone services sure look like telecom's future, with gads of extras at low cost. They might even play you an old Waylon Jennings song. ■

THE LOWDOWN ON WEB PHONES

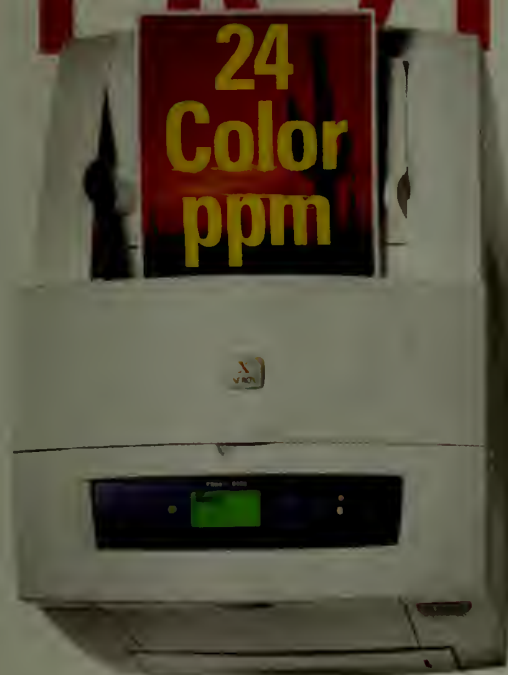


Once just gadgets for geeks, Net phones have become so mainstream that you can pick one up at Best Buy or Wal-Mart Stores.

MODEL	PRICE/ ACTIVATION FEE	THE GOOD, THE BAD, THE BOTTOM LINE
AT&T CALLVANTAGE	\$29.99 mo.*/ \$29.99	It's pricier than other services, but call quality and technical support are excellent
PACKET8	\$19.95 mo.*/ \$29.95	Rock-bottom rates, excellent voice quality, and optional videophone service, but it lacks 911 capability
SKYPE	Free*/ None	Using a PC with a microphone, you can make free calls to Skype members or to any phone for about 2¢ a minute
VONAGE	\$24.99 mo.*/ \$29.99	Good call quality; extras include 911 service and the ability to keep your old phone number when you switch

Data: CNET.com

HOT COOL



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MEDIA MOGULS

Finally, the desktop computer is all set to be the entertainment hub of your home. **By Andrew Park**

AFTER YEARS OF BEING banished to dusty spaces under desks or behind computer monitors, desktop PCs are finally ready to take their rightful place in the living room. Armed with Microsoft's vastly improved Windows XP Media Center Edition software, the new crop of PCs can serve as home entertainment hubs, with the clean look and easy operation of consumer electronics gear but the brains to do much more. In short, the entertainment features are finally demonstrating their worth, making the Media Center the most radical makeover of the PC since the arrival of Windows 95 a decade ago.

Want one? In a stark contrast to 2002, when the Media Centers made their debut, there's a wide array of options out there. They range from modest desktops that can bring TV viewing and other entertainment features to an office or dorm room to sophisticated and expensive machines designed as yet another component in a home entertainment rack.

While Apple bills its Macintosh—also an outstanding choice for home buyers—as the hub of digital entertainment, only Microsoft has delivered true integration of computing and video entertainment.

Just ask Petar Vucetin. When the 35-year-old software developer bought his Alienware PC in early October, he didn't relegate it to a desk in his Birmingham (Ala.) home. It landed right beside his DVD player, TiVo recorder, and 43-inch plasma-screen TV. The striking black computer, no bigger than a high-end stereo receiver, looks right at home—unlike the Dell Dimension minitower he also considered. "Their box looked awkward," he explains. "I mean, where are you going to put that thing?"

"This Is the Future"

VUCETIN'S ALIENWARE DHS, tricked out with 2 gigabytes of memory and a 200-gigabyte hard drive, cost him a cool \$3,400. He admits being lured in by its sharp lines. But he bought it because, with a single remote control from across the room, he can burn digital movies onto

DVDs, download tunes from Napster to listen to on his stereo, and record episodes of his favorite TV show, *Lost*, when he's out of town. Just as easily, he can download feature films from Movielink and CinemaNow to watch anywhere in the house. And, when he has a party, he can play his favorite Internet radio stations. "This is the future," he says.

It's one small step for home entertainment, but one giant leap for the PC. More than a third of U.S. households have computers in their living rooms today, but because the hardware and software haven't been up to snuff, few families use them for home entertainment. This year's Media Center models will change that by exploiting the PC's speed, its vast storage capacity, and the ease with which it can be linked with home networks.

The best example may be Hewlett-Packard's \$1,999 Digital Entertainment Center. HP was one of the first PC makers to offer a Media Center two years ago, but it went back to the drawing board this year. Like the Alienware DHS and CyberPower's \$1,255 Media Center PC Limited

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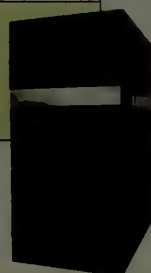


MULTITASKER
The Alienware DHS
looks sharp, too

IT'S SHOWTIME

Ready to invite a PC into your living room? Let one of these elegant numbers entertain you.

MODEL	PRICE	SPECS	THE GOOD, THE BAD, THE BOTTOM LINE
HP DIGITAL ENTERTAINMENT CENTER Z545-B	\$1,999	3 GHz Pentium 4, 512 MB RAM, 200-GB hard drive	This versatile model makes up for the lack of an HDTV tuner by adding wireless networking and a second hard drive that pops out for use with other PCs
SONY VAIO RA820G DIGITAL STUDIO PC	\$1,699	3.2 GHz Pentium 4, 1 GB RAM, 200-GB hard drive	Just as big as a regular PC, but a unique cooling system and bold, futuristic styling ensure this powerful machine will be seen but rarely heard
ALIENWARE DHS 5	\$1,783	3 GHz Athlon 64, 512 MB RAM, 80-GB hard drive	One of the first on the market with living room looks, the DHS 5 will fit right in with AV components. But the base system is as noisy as a PC and lacks key features, so it's worth upgrading
NIVEUS MEDIA DENALI EDITION	\$3,999	3.2 GHz Pentium 4, 1 GB RAM, 320-GB hard drive	Fanless system operates silently, and it's the only one of a few that can handle high-def TV. But the price is as steep as the peak it got its name from



Data: BusinessWeek, company reports

Edition, the HP Entertainment Center has a 17-inch-wide black, brushed aluminum case with a two-line LED screen to display such information as album titles and TV channels. On the back, HP junked the PC's usual thicket of ports for a simpler layout of input and output jacks necessary to connect the computer to other home entertainment components, making the hook-up process as friendly to couch potatoes as computer geeks.

Noise Factors

INSIDE THE Entertainment Center are all of the ingredients of a top-of-the-line desktop PC. HP gave it a fast Intel Pentium 4 processor, a 200-gigabyte hard drive, a gigabyte of memory, and built-in wireless networking. There are two TV tuner cards, which means you can record two shows at once or watch one live while recording another. There's a wireless keyboard and mouse for Web surfing and instant messaging from up to 10 feet away, and a 160-gigabyte portable hard drive that pops out so you can access your media files from other PCs.

The new Media Center PCs are not without flaws. For now, Media Centers, even when equipped with high-definition TV tuners, can only handle over-the-air high-definition TV content—not cable or satellite HD. Microsoft plans to offer full support for HDTV early next year, including so-called cable-card-equipped models that will allow you to eliminate your cable set-top box.

The biggest challenge PC makers are still trying to overcome is noise. The fans that dissipate the heat from high-performance PC processors also generate

low-level sound that competes with your TV and stereo. The solution is a fanless system, such as the Denali Edition from boutique maker Niveus Media. The Denali runs silently, but at \$3,999 it's designed for high-end home theaters.

For the first time, Media Center PCs appear at the other end of the spectrum, too. HP, Gateway, and Dell all are planning to offer the system on conventional-looking PCs costing well under \$1,000. For \$300 more, you can add a networked HP or Linksys Media Center Extender that lets you access the entertainment features and all your music, video, and photos from up to five TVs in the house.

For those willing to open their PC case to install hardware, SnapStream's BeyondTV package offers a sort of poor man's Media Center: It can turn any PC running Windows XP into a TiVo-like personal video recorder for just \$150, including an internal TV tuner.

Sony, as usual, has its own take on the Media Center. The \$1,699 Vaio RA820G Digital Studio PC adds its own software for digital moviemaking, DVD burning, and sharing media files on a home network—and gives the minitower an extreme makeover. The size of a conventional PC, the bold, matte-black case looks best sitting horizontally in an entertainment center. Positioned that way, it shows off a large, see-through opening, part of an advanced liquid cooling system that significantly reduces noise. It handles almost any home entertainment task, thanks to such features as a double-layer DVD burner, high-end audio output, and room to upgrade to as much as 1.6 terabytes of storage. That's a \$1,600 option, but it would provide enough storage for virtually limitless video recording.

For anyone expecting to pay \$399 for a new PC, that may sound a bit much. But with movies, music, and TV all going digital, it may finally be time to let Microsoft into the living room, even if it means a big investment. These PCs look so good, you can fire the interior decorator. ■



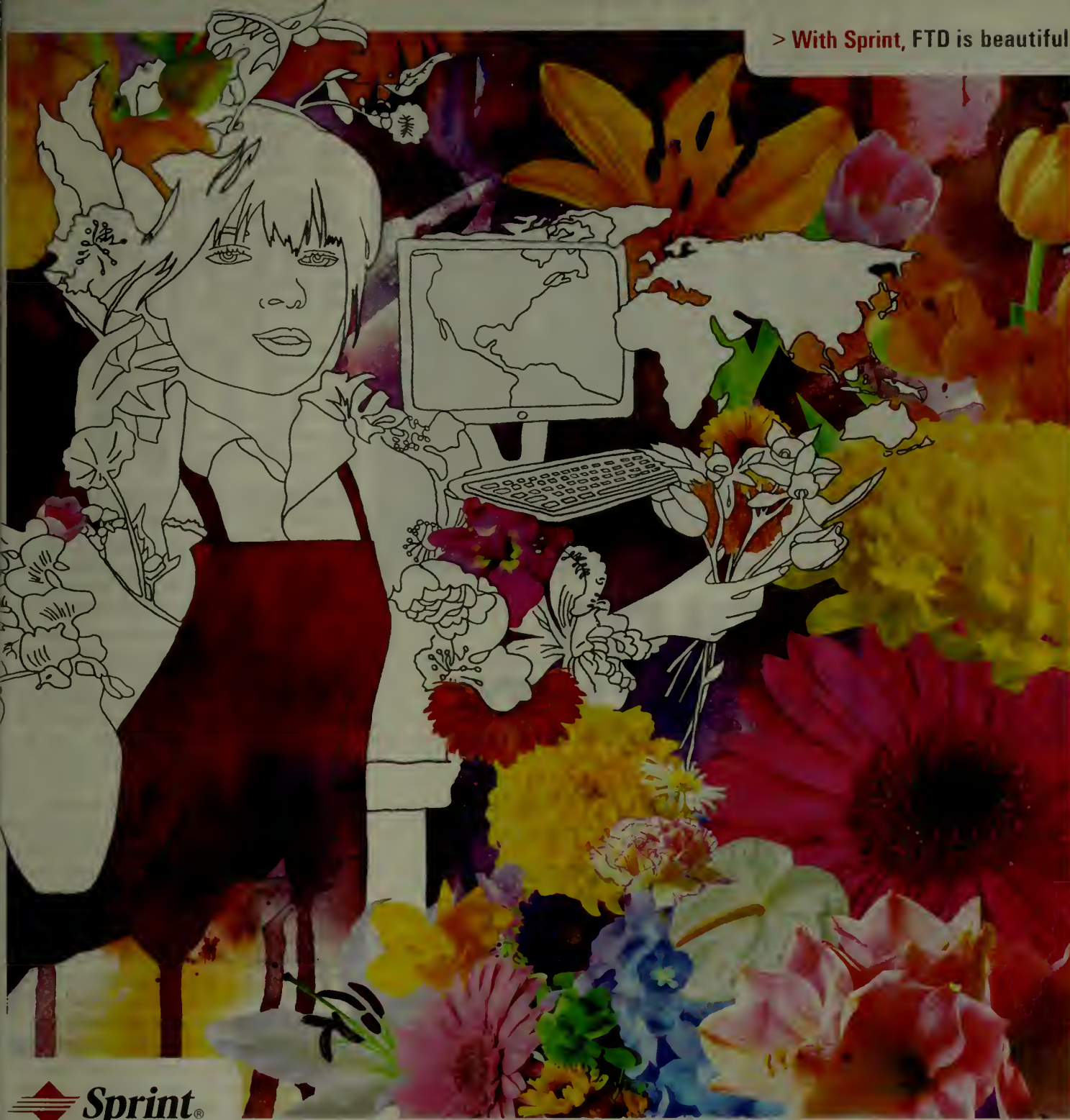
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HARMONY 680 UNIVERSAL REMOTE CONTROL
\$130/LOGITECH INTERNATIONAL/LOGITECH.COM

Media center PCs are ready for their close-up, but their flimsy remotes won't make anyone's A-list. The Harmony 680 is a pricey replacement, yet doesn't sacrifice brains for good looks. It turns on your PC's entertainment functions with the touch of a button, and you can download programs to control everything else, from TVs to TiVo, just by listing your equipment at Harmony's Web site.

BusinessWeek online For the best TVs to show off your Media Center PC, go to www.businessweek.com/magazine/extra.htm

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HEAVY-DUTY LIGHTWEIGHTS

Laptop manufacturers keep tipping the pound-performance ratio in your favor. **By Stephen H. Wildstrom**

LIKE MANY ROAD WARRIORS, Julian Nott is never without his laptop. But his Fujitsu LifeBook P7000 travels more than most: It's as much at home hanging beneath a hot air balloon as on a hotel room desk. "I travel extensively, and I take my laptop everywhere," says Nott, a London aeronautical engineer with 78 ballooning records to his credit. Among the unconventional service Nott gets out of the 3-lb., \$1,800 LifeBook: navigating his balloon using an attached global positioning system receiver.

Not many notebooks will ever see 50,000 feet up in a balloon, but there is a laptop for just about any purpose you can imagine. For years, laptops for the masses were mostly knockoffs of computers intended for the larger corporate market. But consumer purchases have surged, and manufacturers have rushed in with

distinctive products ranging from ultralights to monsters with 17-in. displays, all aimed at individual buyers.

Entertainment-friendly displays and thinner, lighter packages dominate this year's laptops. In a break with corporate design, today's consumer notebooks sport

RIDING HIGH
Balloonist Julian Nott uses his LifeBook for GPS tracking

screens optimized for video rather than text. Many have widescreen displays designed to fit the format of DVD movies. Polished screens show off games and movies with a vividness and depth lost on displays with anti-glare coatings. (The trade-off: Text is harder to read under some lighting conditions.)

A second trend is that consumer notebooks, even the heftiest units designed as alternatives to desktop computers, are getting thinner and lighter. And just like their business-oriented cousins, virtually all consumer laptops now offer built-in Wi-Fi wireless networking.

Loveable Luggables

IF YOU'RE SHOPPING for a laptop, the first thing to do is to set your budget and decide how you plan to use the computer. Make sure that you're comfortable with the keyboard and the touchpad or other pointing device. If you watch movies on airplanes, make sure the laptop has a widescreen display and enough battery life. If it's always hanging from your shoulder, weight is important. These are the features you're going to become intimate with—not the brand name, hard disk size, processor speed, or other specifications.

Nott's LifeBook is a good example of an ultralight. It features a 10.6-in. display whose widescreen design allows use of a nearly full-size keyboard in a very compact package. Unlike corporate ultralights such as the IBM ThinkPad X41, the LifeBook P7000 includes a built-in drive that plays DVDs and reads or writes CDs. The use of an ultralow-voltage version of Intel's Pentium 4 processor helps to deliver more than 10 hours of battery life.

If you'd rather have a bigger and more conventional display, check out Panasonic's ToughBook Y2, with its huge—for this class—14.1-in. display. It's a bit heavier than the LifeBook at 3.4 lb., more expen-



POWER TOOL

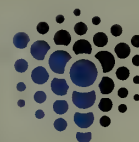
WIFLYER PORTABLE BASE STATION
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Set up a wireless network anywhere, with or without a high-speed connection. The palm-sized WiFlyer Wi-Fi access point comes with a built-in 56K modem and dial-up numbers for the major service providers, so that you can create a hot spot anywhere there's a phone line. Sure, the Web connection will be slow, but you'll be able to use your wireless laptop in homes and hotel rooms that don't have broadband yet

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nanocubic



COMPUTERS LAPTOPS

sive at \$2,500, and it can run only about four hours on a battery charge.

The workhorses of the laptop world are the thin-and-lights, weighing between 4 and 6 lb. and using Intel's Pentium M or Celeron M, or Advanced Micro Devices' Athlon XP-M processors. A typical pick: the 5-lb. WinBook X Series. Gwynyth Mislin's WinBook is her constant companion. "I bought a big Coach purse so I can travel with it more easily," says the Columbus (Ohio) writer.

Most of these consumer notebooks come with a 12.1-in. widescreen display, instead of the TV-shaped 14-in. screen found on corporate products. The Dell Inspiron 700m is characteristic of the breed: 4.2 lb., 60-gigabyte hard drive, built-in DVD, and priced at \$1,300 and up. The striking Alienware Sentia is de-

signed for speed, and it's one of the snappiest-looking notebooks around. It's more expensive, with prices starting at \$1,572, but a bit lighter at 3.8 lb.

Great Performances

THE MOST VARIED and fastest-growing class of notebooks are those designed as alternatives to desktops. There are models offering maximum performance in a portable, if not particularly mobile, format; products focused on home entertainment; and a third category designed to cram in maximum value at the lowest possible prices, often well under \$1,000.

The \$3,000 Dell Inspiron XPS (Extreme Edition) is at the far end of the performance scale. Aimed at dedicated gamers, it is built around Intel's fastest desktop processor, a 3.4-gigahertz Pen-

tium 4 Extreme Edition. But at 9 lb., it's not very mobile.

Apple offers some of the best software around and its 17-inch PowerBook G4 is an outstanding desktop replacement. Its 6.9-lb. weight and four-plus hours of battery life make it more mobile than many in its class.

More mainstream are big laptops with lots of entertainment options. Toshiba has launched a new brand, Qosimo, for laptops that include TV tuners and run Microsoft's Windows XP Media Center Edition. The \$2,600 E15-AV101 weighs over 8 lb., but it's not going to move much once it's connected to cable or satellite TV. The Hewlett-Packard Pavilion DV1000, starting at \$899 with an Intel Celeron processor, is a much cheaper alternative: There's no TV, but you can

play DVD movies on the 14-in. widescreen display without ever booting up Windows, and the battery life is better than most.

The fastest-growing category of consumer laptops is big, inexpensive boxes designed for folks who don't want a traditional room-dominating tower computer but whose view of mobility is often limited to moving the computer from living room to den. The HP Compaq Presario R3000T, at \$950 with a 15.4-in. wide-screen display, is typical. At \$800, the Gateway M520CS offers an even cheaper alternative with a 15-in. standard-shaped display and a slower processor.

If you're looking for a powerful but low-cost laptop, it may be worth waiting until early next year. Intel is slashing the price of its mobile Pentium M and Celeron M chips and laptop makers plan to drop the desktop processors. The results will be lighter notebooks with better battery life.

The huge variety in notebook computers is a new bonanza for consumers but it can make shopping intimidating. If you consider all the possibilities, you're likely to find something that suits you. Unless you're like Nott, that is, who'd rather have something lighter than air. ■

—With Jennifer Drew

GOOD ENOUGH TO BE YOUR MAIN MACHINE

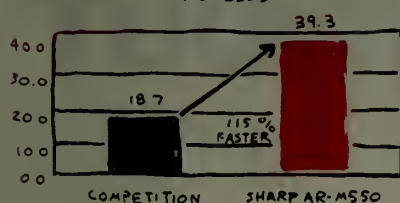
Laptop computers are packing bigger screens and more punch than ever



MODEL	PRICE	SPECS	THE GOOD, THE BAD, THE BOTTOM LINE
THE BUDGET BUYS			
AVERATEC 6200	\$1,150 to \$1,329	6.2 lb., 15.4-in. widescreen display, AMD Athlon XP-M, 512 MB RAM, 60-GB hard drive	This competitively priced laptop comes with a remote to turn the power on for DVD movies without booting the computer, but computing performance is extremely basic
HEWLETT-PACKARD PAVILION DV1000	\$1,274 and up	5.3 lb., 14-in. display, Intel Pentium M 1.5 GHz, 512 MB RAM, 80-GB hard drive	Lightweight, with above-average battery life, the Pavilion dv1000 is a sensibly priced system for students, families, and small-business owners who want to work and play on the road
THE ROAD WARRIORS			
PANASONIC TOUGHBOOK Y2	\$2,341 to \$3,201	3.4 lb., 14.1-in. display, Intel Pentium M 1.3 GHz, 256 MB RAM, 40-GB hard drive	The expensive ToughBook Y2 is the thinnest and lightest in its class, and battery life is an impressive five hours
DELL INSPIRON 700M	\$1,304 and up	4.2 lb., 12.1-in. widescreen display, Intel Pentium M 1.60 GHz, 256 MB RAM, 60-GB hard drive	Nicely designed notebook with a size and weight made for the road, but it comes up short on battery life: You'll need a spare
THE DESKTOP DO-IT-ALLS			
DELL INSPIRON XPS EXTREME EDITION	\$2,962 and up	9 lb., 15.4-in. widescreen display, Intel Pentium 4 3.4 GHz, 1 GB RAM, 80-GB hard drive	Its screaming performance offsets the high price, short battery life, and massive size. One of the best gaming laptops we've seen
APPLE 17-INCH POWERBOOK G4	\$2,225 to \$2,694	6.9 lb., 17-in. widescreen display, PowerPC G4 1.5 GHz, 512 MB RAM, 80-GB hard drive	The first laptop to boast a 17-in. screen offers a unique backlit keyboard, gorgeous display, sleek anodized aluminum case, and relatively light weight

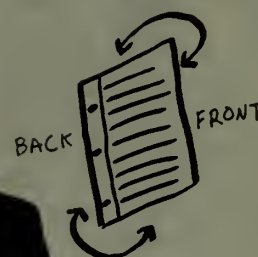
Data: CNET.com

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REVIEW By Steve Hamm

A WORLD WITHOUT MICROSOFT

A FEW WEEKS AGO, I WAS hijacked. No, it had nothing to do with planes, trains, or automobiles. My personal computer was invaded by a rogue program called Home Search that took control of my Internet Explorer browser, afflicted me with a plague of pop-up ads, made itself nearly impossible to remove, and finally brought my computer to a grinding halt. It took me seven hours on the phone with a Microsoft technical-support person to get rid of this menace.

I was fed up and decided to see if I could survive in a world without Microsoft. In fact, I would abandon the commercial software realm altogether and use so-called open-source programs, which seem to be less prone to viruses and spyware, for everything from my operating system to my browser to my desktop applications. While some open-source software is available commercially, thousands of programs are free on the Web.

Weakest: Linux

USING OPEN-SOURCE programs would turn out to be no Sunday afternoon stroll. While open-source programmers have tried to make their products easy to use, and several that I tried were as good or



better than their Microsoft counterparts, others literally gave me a headache.

Getting the Linux operating system loaded on a PC was the thorniest part. The first stop on my quest was leading Linux distributor Red Hat (redhat.com). But to install its free version, I would have to repartition my hard drive to make space for it. Fortunately, I found

Mandrakelinux (mandrakelinux.com), with a partitioning program built in. Still, it took six hours to download, and, because I had trouble figuring out how to configure the system, I had to install it twice.

Then, more frustration. Mandrake came with the GNOME user interface, comparable with Windows' icons and menus. It was familiar and easy to navigate, but I had trouble finding and opening a couple of programs that I had downloaded from the Internet. Things just weren't as simple as with Windows.

Once I got beyond Linux, things got fun. It took under a minute to download and install the Firefox browser from mozilla.org. Firefox worked fast and has a nifty feature called tab browsing: You can open multiple Web sites at once and switch

quickly between them.

Firefox is wildly popular. More than five million people have downloaded the preview version since mid-September because it isn't affected by all the viruses aimed at Internet Explorer. I had no problems with viruses or spyware, even though I searched for half an hour looking for "free stuff," trying to trigger an attack.

I also installed an alternative to Microsoft's Office suite, OpenOffice (openoffice.org). While others have warned of compatibility glitches, I found none. The OpenOffice applications had all the capabilities I needed to type this story and perform other routine tasks.

Experiment over. I've largely returned to the Windows world, but because many open-source programs run on Windows as well as Linux, I've made the switch to Firefox, and I'll never buy Microsoft Office again. Who knows, if I run into a few more glitches with Windows, I may even give Linux another shot. ■

HOW FREE SOFTWARE STACKS UP

Open-source software has made great strides, but some is still too complicated for tech lightweights like me.

LINUX	Mandrakelinux, a version of the Linux operating system, that is an alternative to Windows, was easier to install than other Linux systems. Still, I ran into a few glitches. I'll stick with Windows for now
FIREFOX	This nifty new Web browser leaves Microsoft's Internet Explorer in the dust. Firefox is small, fast, and not plagued by spyware. I'm not going back to IE
OPENOFFICE	It's a suite of word processing, spreadsheet, and presentation applications that are roughly comparable to Microsoft Office. The files I created with OpenOffice and Office were compatible. I won't buy Office again

Data: BusinessWeek

VISUALIZING BUSINESS INTELLIGENCE

INFORMATION OVERLOAD

It's a condition plaguing virtually every business decision-maker, from financial analyst to CEO. Not only are today's decision-makers being confronted by too much information, but vital data is being generated at such a rapid pace that most people cannot internalize it fast enough to make the instantaneous decisions hyper-competitive business environments demand.

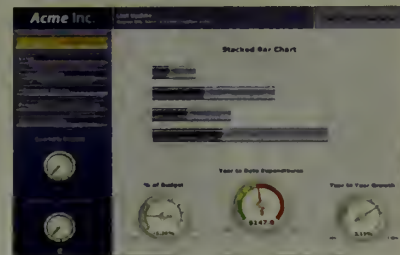
And that's not the worst part. Even when actionable data is available, it's typically presented in a format only optometrists would love: dense Excel files and static PowerPoint charts that tax the eyes as much as the mind. Critical data relationships are difficult to discern. And trying to intelligently compare alternative scenarios or to analyze the behavior of key variables over time is a task that, all too often, strains the abilities of even the most seasoned executives.

Faced with similarly mission-critical decisions, airline pilots have long immersed themselves in ultra-realistic flight simulators that vividly depict every scenario and consequence until they know instinctively which course of action is best in any circumstance. Until recently, business executives have lacked the same powerful interactive tools that would enable them, at a glance, to know which choices were right for their business, and to communicate

this vital decision-making information to customers, colleagues, and investors.

Now, all that has changed. Xcelsius, the award-winning real-time data-presentation tool from Incommersion, makes it easier than ever for decision-makers to identify critical data relationships, to probe elaborate "what-if" scenarios, or to peer into a company's possible

	Q1	Q2	Q3	Q4	YTD
Revenue	100,000	120,000	110,000	130,000	460,000
Expenses	(80,000)	(90,000)	(85,000)	(95,000)	(350,000)
Profit	20,000	30,000	25,000	35,000	110,000
Profit Margin	20%	25%	23%	27%	24%



financial futures. Integrating with company data-gathering systems, Xcelsius brings static Excel files and charts to life by animating key data points in real-time. And Xcelsius' intuitive point-and-click interface and seamless import and export functions (to PowerPoint, Outlook, and the web) make it a snap for non-technical users to create fully interactive corporate dashboards, as well as information-rich charts, graphs, calculators, and budget models—all within minutes.

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XCELSIUS

BIG TELEVISION

The lowdown on high-definition TV: There are more choices for your living room than ever before. **By Cliff Edwards**

REMEMBER NEO'S DILEMMA in *The Matrix*? Morpheus offers him two views of reality, extending a blue pill in his left hand and a red one in his right. Anyone shopping to equip a high-definition home theater this fall may have a similar *Matrix* moment. Only in this rendition, Morpheus will be offering up a rainbow of choices for products and services—any one of which might precipitate buyer's remorse.

So what's the road best traveled when it comes to the high-definition experience? In my quest to find out, I looked at the latest in 42-in. and 50-in. plasma TV sets from Panasonic, Pioneer, and Sony as well as LCD TVs from Dell and Samsung. Then I compared services from DirecTV, DISH Network, and Comcast—the leading cable and satellite providers in my area—judging them on the basis of picture quality, volume of HDTV programming, and ease of recording. My conclusion is that setting up a high-definition theater today is both affordable and sensible: If you choose

carefully, products on sale right now could keep you satisfied for many years.

That's not to say the choices are simple. The first step is figuring out which screen is best for your home. That obviously depends on personal tastes, budget, and the size of the room where the TV will reside. The cheapest route to HDTV is a conventional tube-based set, which you can get for under \$1,000. But nobody enjoys sacrificing whole swaths of the living room for a box the size of a washing machine. That's why the action in home theaters is quickly shifting to thin and light flat-screen TVs.

Sharper and Sharper

OF THESE, THE THREE fastest-growing categories are rear-projection, plasma, and liquid-crystal displays (LCDs). Rear-projection sets typically cost less than the alternatives, but there are trade-offs. Most such TVs are at least twice as thick as plasma and LCD sets. And the subcategories in the projection market can be baffling. You'll find models based on "digital light processing" chips, LCD panels, and a tech-

nology called liquid crystal on silicon (LCOS). Don't get hung up on these. All three approaches offer great pictures. The one caveat is that rear-projection screens generally look best in a darkened room.

For bigger spenders, plasma displays are the preferred choice. But not all such screens are created equal. Salespeople in electronics shops will explain the differences using ungainly terms such as "native resolution" and "480p vs. 1080i." You can bone up on the fine points of pixels and "scanning lines" at hdtv.cnet.com and other Web sites dedicated to HDTV, but it isn't essential. The one distinction that will matter right away is whether you want so-called enhanced definition (EDTV), or a higher-resolution display. The former choice will basically limit viewing to the quality you get from a good DVD player. If you can afford to step up to a high-definition set, it will pay off two years down the road when a lot more HDTV programming will be available.

At the moment, EDTVs are one of the hottest categories in plasma sets. They



PIONEER Plasma
is a hot seller at
42 inches and up

generally cost less than \$3,000, and the pictures look great. Panasonic's hot-selling 42-in. TH-42PD25U/P EDTV offered clear, bright pictures of a Green Bay Packers game, but crowd shots and other finer detail looked blurry when viewed side by side with higher definition sets from Sony and Panasonic for \$5,500 or less. Pioneer's equally impressive 50-inch PDP5040HD sells for about \$6,000. Be sure to check out plasma sets from Fujitsu and Samsung, too.

There are some disadvantages to plasma technology. Older plasma sets are prone to "burn-in," where static images such as paused game scenes, black space, or station logos appear as a ghost on the screen that can't be erased. Plasma displays also lose their brightness over an extended time. If you kept a set running day and night, it would last for about 2½ years, compared with a five-year projected life span for liquid-crystal displays. LCDs also tend to be lighter, about an inch thinner, and more energy-efficient. Samsung's ultracool 46-in. LTP468W, for \$8,000, is the first LCD capable of displaying all forms of HDTV.

The next issue to resolve is how you would like to receive your HDTV signal. The three options right now are via cable, satellite TV, or over the airwaves. The last option is the simplest. It's free and requires nothing more than a built-in tuner and an antenna such as Terk's \$39.99 HDTV. But reception may be spotty, depending on where you live.

Of the three for-pay cable and satellite services I compared, all had excellent features at comparable prices, but there were



POWER TOOL

NINTENDO DS

\$150/NINTENDO/
NINTENDO.COM

As if video gamers weren't distracted enough. From Nintendo, whose Gameboy already dominates handheld gaming, comes this dual-screen number. One lets you navigate the game while the other shows a game overview or statistics. Or you and a friend can battle each other wirelessly.

differences. Comcast had the best all-in-one deal. It had an impressive high-definition lineup, including all the major local networks, and something called On Demand, which offers a downloadable library of premium channel shows and pay-per-view.

Plugged In

THE COMCAST SERVICE got three demerits, in my book. The film library was limited, compared with what you can get from a DVD rental outlet. I was also turned off by the fact that a third of its channels still are broadcast in analog, which looks lousy on a big screen. And Comcast came up short in providing a system for recording shows. A year ago, Comcast, Time Warner,

Cox, and other cable-TV companies began advertising HDTV cable boxes with TiVo-like recording systems built by Motorola and Scientific-Atlanta. Prices run about \$10 a month, which covers equipment rental and service. But the boxes are unavailable in many areas, including mine.

The all-digital satellite providers were more to my liking. DISH, for example, offered eight HD stations, which could be recorded with a \$1,000 DISH digital video recorder. The system offers picture-in-picture capability that lets you look at two shows at once, even if this is not a standard feature on your TV.

DirecTV was my favorite of the paid services—but not by a wide margin. I especially appreciated the \$1,000 high-definition TiVo box, which benefits from the graceful TiVo interface and also aggregates over-the-air TV signals along with DirecTV programs in the same program guide. That helped offset the satellite provider's extremely skimpy local HDTV lineup and an \$11-a-month add-on cost for a complete HD package.

To round out a home theater, I recommend a Bose Lifestyle 48 sound system (\$4,000 including DVD player) and a Monster power adapter to protect your system from electrical surges. Whether you choose plasma over LCD or satellite over cable, there will be no shortage of digital delights. ■

LIQUID CRYSTAL
The Dell W2600



BusinessWeek online For more on home theaters, please visit us online at www.businessweek.com/magazine/extra.htm

GETTING THE BEST PICTURE

High-definition TV has arrived, but not all approaches are created equal

PROVIDERS	PRICE	THE GOOD, THE BAD, THE BOTTOM LINE
CABLE	\$65-\$120 mo.	Comcast and other providers offer HDTV programming galore, including local channels and free video-on-demand
SATELLITE	\$65-\$100 mo.	DirecTV, DISH Network, and Voom transmit lots of sports, but local high-definition offerings are sparse to nonexistent
OVER-THE-AIR BROADCASTS	Free	You need an antenna and a built-in ATSC tuner or set-top box, but pictures are more vibrant than on cable or satellite
BIG-SCREEN TVS	PRICE	THE GOOD, THE BAD, THE BOTTOM LINE
PLASMA	\$2,200-\$12,000	Big sets have bright, clear pictures but are power hogs. Many hot-selling models can't display true high-def TV
LCD	\$3,000-\$10,000	Pricier than plasma, LCD screens are lighter and more energy-efficient. Sets larger than 50 in. are scarce
REAR-PROJECTION	\$1,500-\$4,000	Popular models use digital light processing (DLP) or LCD projectors. Sets are best watched in darkened rooms

Data: BusinessWeek

Introducing data centers on demand

New architecture supports power densities of today... and tomorrow



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More computing power, but with more heat...
presents a serious problem for companies unprepared
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APC plays the hero with a three-component environmental system."

InfoWorld 3/12/2004

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ISXT2MD6R	6	up to 5kW	\$149,999*
ISXT2MD11R	11	up to 5kW	\$249,999*
ISXT2MD40R	40	up to 5kW	\$699,999*
ISXT2MD100R	100	up to 5kW	\$1,649,999*
High Density Configuration (shown above)			
ISXT2HD8R	8	up to 10kW	\$399,999*

High density upgrades start at \$10,999

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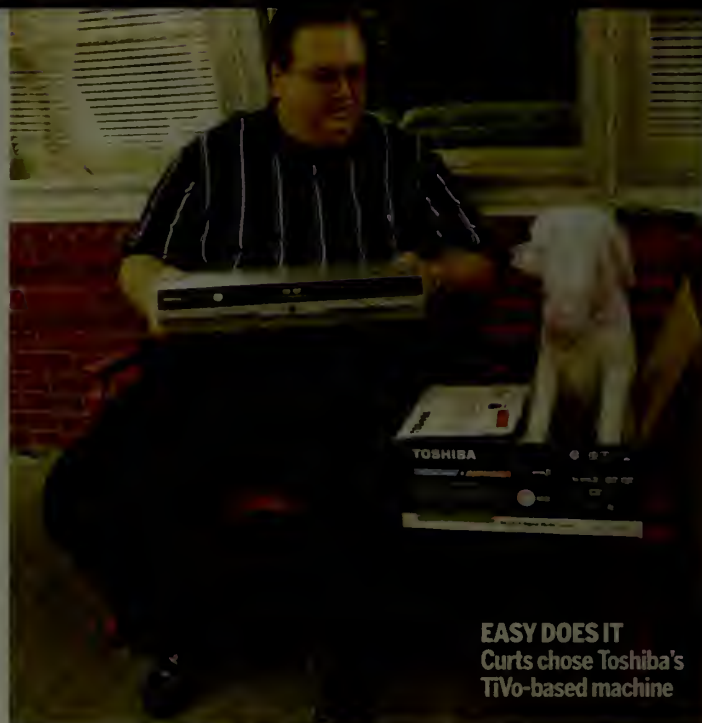


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UPPING THE DVD ANTE

Who needs TiVo? New, feature-rich recorder-players have loads of storage and are a cinch to use. **By Jay Greene**



EASY DOES IT
Curts chose Toshiba's
TiVo-based machine

NO QUESTION, ONE OF the most innovative technologies of the past decade came from a tiny company named TiVo. It put a big hard drive next to your TV so that you could record shows to watch later, or pause or rewind them while you were watching.

Now, the big consumer-electronics companies think they have figured out a better way. They've put the hard drive in the same box as a DVD recorder—a neat, if expensive, way to replace your old VCR. Some products include on-screen program guides so that you can set shows to record with a click of the remote.

But it turns out that the best of this new breed of would-be TiVo-killers relies on TiVo technology itself. That's Toshiba's RS-TX20, a \$470 DVD recorder with a 120-gigabyte hard drive that can store about 140 hours of TV programming. The TiVo software, in fact, is why Doug Curts, a security guard at Churchill Downs in Louisville, bought the Toshiba. "They've got it down pat. They make everything easy," he says.

Basically O.K.

THIS RECORDER COMES WITH the little-known TiVo Basic service, which allows easy TV recording but doesn't require a subscription. TiVo hopes you'll upgrade to full service, which costs \$12.95 a month and includes extras, such as searching for programs by name or recording only first-run shows, not repeats. But the bare-bones service does the trick if all you're after is an easy way to

record shows and copy them onto DVDs.

And it does it better than its competitors. Most of the recorders that provide a program guide use the free TV Guide On Screen service, a jumble of channels that may not include all the channels you receive. What's more, the guide doesn't work with satellite TV and some digital cable boxes. TV Guide beats TiVo Basic in only two ways: You get eight days of listings instead of three, and you don't need a phone jack by the TV to get its guide.

Among the recorders that don't use TiVo, perhaps the best is the \$600 Philips HDRW720. It comes with a 120-gigabyte hard drive that, like the TiVo machines, continually records the program you're watching. That means you can pause the TV to answer the phone and later pick up the program right where you've left off. Then you can fast-forward through

commercials to catch up to live television.

Panasonic's \$700 DMR-E95H, which also uses the flawed TV Guide service, has a few glitches of its own. Its Direct Navigator function, for example, displays a screen with thumbnails of programs you've recorded, but from there it's not obvious how to burn them onto a DVD.

If you've learned to program your VCR, you might be happy with a low-end recorder without a program guide, such as Pioneer's DVR-520H. But don't expect the ease of one-click recording: You have to manually set record times, or punch in VCR Plus codes from the newspaper.

It turns out that, if you're looking for a would-be TiVo without the monthly fee, your best bet is to find one that runs TiVo Basic. Try as they can, other search-record-burn schemes just aren't quite ready for prime time. ■

ALMOST TiVo

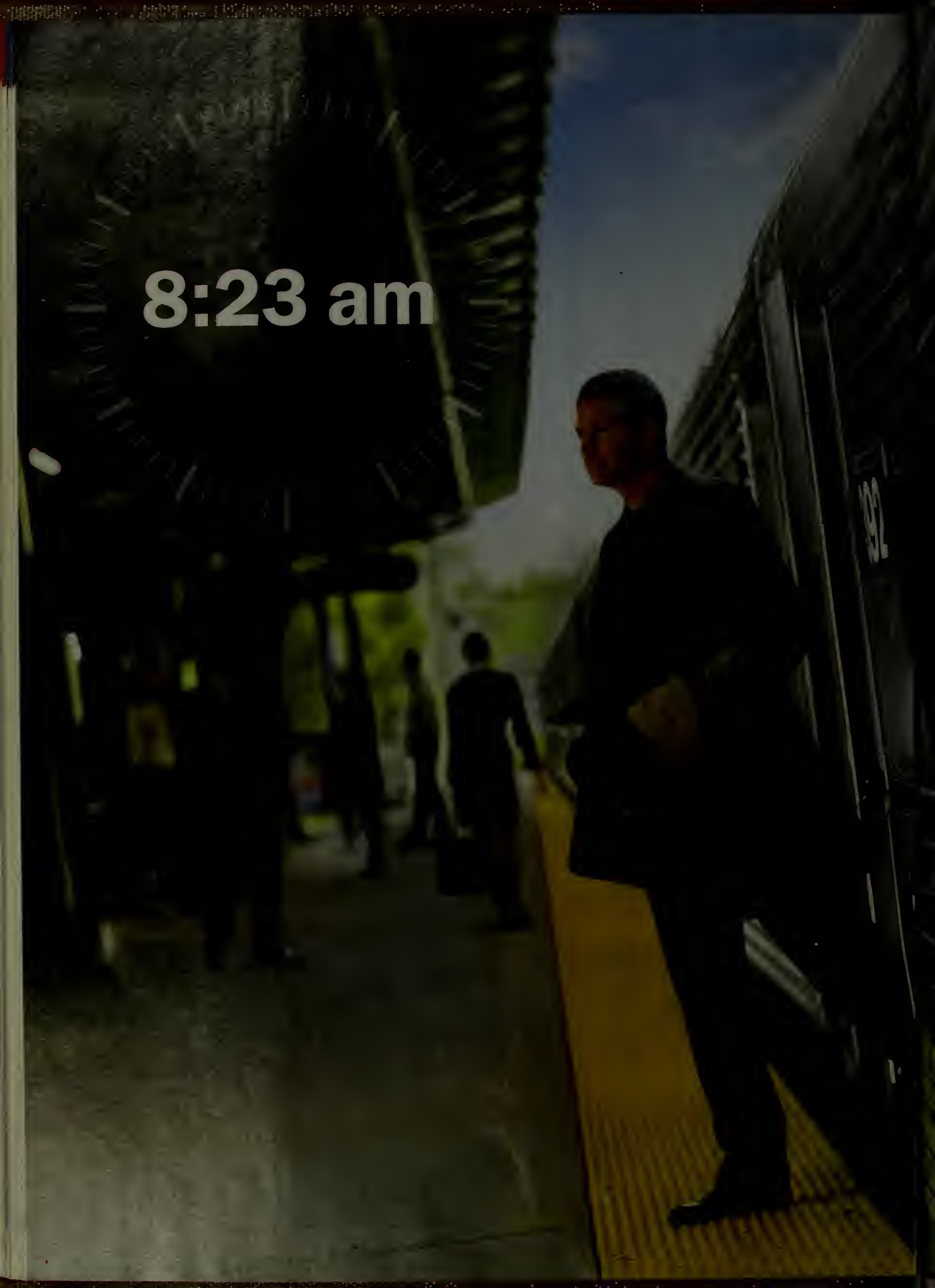
DVD recorders with built-in hard drives don't yet match TiVo's features, though they can archive programs to DVD

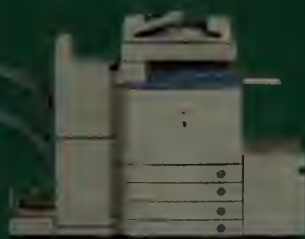


MODEL	PRICE/MAX TIME	THE GOOD, THE BAD, THE BOTTOM LINE
PANASONIC DMR-E95H	\$618-\$799/ 284 hrs	Comprehensive features include a program guide and a FireWire connection for camcorder dubbing
PHILIPS HDRW720	\$559-\$599/ 192 hrs	A buffer stores the program you're watching, giving this model pause and instant replay features
PIONEER DVR-520H	\$489-\$599/ 102 hrs	The lack of a built-in program guide make this Pioneer recorder little more than a digital VCR
TOSHIBA RS-TX20	\$469-\$599/ 140 hrs	This TiVo-powered recorder is the best, but TiVo prohibits editing out commercials

Data: CNET.com

8:23 am





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DIGITAL HOME CAMERAS



EASY SNAPS, PIXELS APLENTY

They're called party cameras, but these digital ultracompacts also can do serious duty. **By Adam Aston**

LEAVE IT TO ONE OF AMERICA's most famous painters to recognize fine design. On a recent trip to Los Angeles, LeRoy Neiman picked up a new digital camera. The camera his assistant Lynn Quayle had been using for years—mostly to shoot the artist on his frequent travels—had just conked out.

Rather than go with something as large as her old full-sized 35mm film camera, they picked Olympus' ultracompact Stylus Verve. Neiman was drawn to the camera's clean lines and softened edges—it tilts to one side like the prow of a yacht. Quayle liked the size: just under four ounces and—at about 2.2 inches tall, 3.7 inches long, and 1 inch thick—roughly the size of a deck of cards. "You needed a purse to carry the old one," says Quayle. "This fits in an evening bag." Plus, the Stylus offers 4 megapixels, enough resolution to meet her travel-picture needs.

A batch of alluring ultracompacts has

burst upon the digital-photography market. These appeal to those who prefer stylish portability over advanced features. Sometimes called "party cameras," they're attracting beginners looking for

EYE-CATCHER
Quayle and Neiman at work with the Olympus Stylus Verve

an easy-to-use first camera as well as shutterbugs who want a second, light-weight digital to keep with them all the time. We looked at five that stand out for their design and don't sacrifice too much in the way of image quality.

Two years ago, picking an ultracompact meant settling for 2- to 3-megapixel resolution—not enough for large, high-quality prints. Today, thanks to ever-cheaper imaging and processing chips, you can buy one of these mini models for well under \$400 and shoot 4- to 5-megapixel images. That's plenty for printing good-quality images at least as large as 8-by-10 in.

Of course, compact design means something has to be left out. The Pentax Optio S5i and the Casio Exilim EX-Z40 have tiny optical viewfinders. The others have none. This can be a problem in dark settings, especially at night, where the liquid crystal display (LCD) screens on these models can't pick up an image until the flash goes off. But in settings with even a little light, these models' bright LCDs do just as well or better than a small viewfinder. The Casio boasts a vibrant screen that measures a generous two inches diagonally—big enough to pass around at parties to show off your work.

To keep prices down, manufacturers tend to skimp on the size of the memory card they include, so it's wise to lay out the extra cash for a bigger one. These models come with no more than 32 megabytes of memory—enough to hold only a couple dozen photos at top resolution.

For about \$70 (check online for the best prices), a 512-megabyte secure digital (SD) card can hold hundreds of top-quality snapshots. Expect to pay twice that price

POCKET-SIZE PRETTY PICTURES

Light as they are, these five runway-worthy digital cameras don't sacrifice performance for looks.



MODEL/ PRICE	RESOLUTION/ SCREEN SIZE	COLORS	THE GOOD, THE BAD, THE BOTTOM LINE
CANON POWERSHOT SD20 \$349	5 megapixels/ 1.5 inches	Blue, gray, red, silver	One of the lightest; cnsp results, but no optical zoom
CASIO EXILIM EX-Z40 \$260-\$350	4 megapixels/ 2 inches	Gold, silver	Excellent battery life and big screen, but picture quality is only average
KYOCERA FINECAM SL400R \$269-\$399	4 megapixels/ 1.5 inches	Silver	Rotating screen; outstanding in continuous shooting mode
OLYMPUS STYLUS VERVE \$279-\$349	4 megapixels/ 1.8 inches	Blue, orange, red, silver, white	Radical shape: Focus is on fashion, not features
PENTAX OPTIO S5i \$320-\$399	5 megapixels/ 1.8 inches	Silver, blue	Good image quality; quick response when you shoot





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Joyce Vonada, CIO
AutoNation, Inc.



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CITRIX®

DIGITAL HOME CAMERAS

for the newer, smaller xD card the Olympus Verve uses.

The best of these cameras make simplicity a virtue. The controls on the Olympus, our top pick, are a model of intuitive design. A unique barrel switch rotates from camera mode to video to playback. When too many buttons are clustered tightly together, as on the more feature-rich Pentax, the manual becomes a must-read.

Taking snaps is just the start. Images must be downloaded and batteries recharged. Most of these models rely on a simple USB cable to zap images into a PC. For power, there's no standard solution. Olympus and Canon take the most complicated approach: a battery you remove from the camera and click into a recharger. Kyocera's Finecam SL400R and Pentax can be plugged in directly. Casio's solution is



POWER TOOL

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Why can't gizmo makers settle on a single format for memory cards? Until they do, SanDisk's ImageMate 8 in 1 Reader/Writer is the best way to beat back the thicket of cables and cradles. The sleek pod connects to any USB port and handles everything from big CompactFlash to tiny xD cards.

the most elegant: Its single docking station both recharges the camera and transfers files to the PC.

In a category with such similar performance features, design twists can make the difference. Like the Olympus, Canon's PowerShot SD20 comes in colors to match

every outfit. With its fixed lens and rectangular shape, the SD20 evokes a classic mid-20th century Brownie camera. Like those old Brownies, unfortunately, it also lacks an optical zoom—a useful feature on the other cameras. The Kyocera's twist is a pivoting screen that makes it easy to shoot from waist level without even crouching. The screen even rotates 180 degrees so you can see yourself, making self-portraits simple.

For its smart button layout and easy-to-use menus, Olympus' Verve edges out

Casio's big screen and simple docking station to win this category. But all of these cameras prove that less can be more: A camera small enough for a shirt pocket or handsome enough to wear around your neck will be ready to snap into action when the perfect image appears. ■

PAPERLESS PHOTO ALBUMS

Switch to a digital camera, and you can stop worrying about those unruly stacks of old-fashioned prints and negatives. But all too often the mess moves straight into the computer, where thousands of digital shots end up scattered across a vast hard drive, many never to be seen again. Ironically, this means that while folks take far more digital pictures, they print and share fewer of them than in the days of the Instamatic.

Photo-album software, which helps to locate, organize, and share digital snapshots, can transform this photo overload into a creative opportunity. The programs are great for novices but can also help more experienced shooters organize their archives.

Lots of new photo organizers are pouring into the market. They range from freeware, such as Google's practical Picasa, to Adobe's more powerful—but harder to use—Photoshop Album (\$49.99). All of them include basic photo editing tools, such as red-eye reduction. For more serious retouching, consider specialized image-editing programs such as Adobe's popular Photoshop Elements or Ulead's PhotoImpact.

At the core of album software is a search engine that scours a hard drive for images and produces a single, tidy view of them, no matter which long-forgotten folders they occupy. You can zoom out to see many pictures at once or focus on just a few, and sort them into batches by topic or by date. Picasa makes this especially easy. In its "timeline" view, the program arranges stacks

of photos along an arc across your computer screen. Sliding the cursor to the left on this arc brings older photos to the fore. This tool makes it easy to navigate vast numbers of images quickly. Using these programs, you can select pictures and send them by e-mail or, for 20¢ to 30¢ a shot, order prints online from Shutterfly or Ofoto.

At \$49, Jasc's Paint Shop Photo Album is the best of this lot. It complements an easy to use set of organization tools with some nice extras such as a photo-backup utility and a deep bank of scrapbook and greeting card templates. These can help turn that unruly cache of digital images into a real-world album worthy of your coffee table.

—Adam Aston

PICTURE OF ORGANIZATION

Photo album software can bring order to scads of snaps

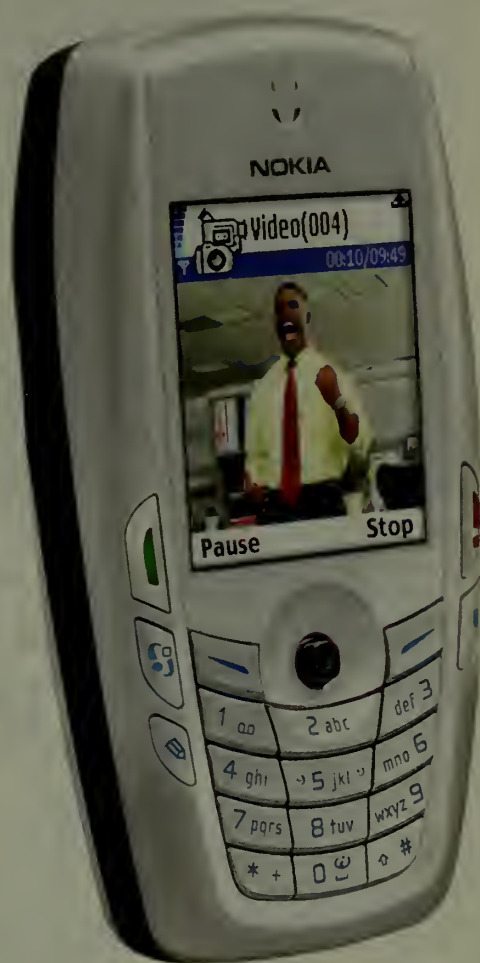
SOFTWARE	PRICE	THE GOOD, THE BAD, THE BOTTOM LINE
ADOBE PHOTOSHOP ALBUM	\$49.99	Works well with Elements, Adobe's more powerful editing program, but controls can be confusing
GOOGLE PICASA	Free	Intuitive design complements speedy search function, but editing features are limited
JASC PAINT SHOP PHOTO ALBUM	\$49.00	A beginner-friendly option that's packed with thoughtful extras for making scrapbooks
KODAK EASYSHARE	Free	This basic software works well with Kodak's popular photo Web site. Users must register to download

Data: Business Week



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SUBSTANTIAL Tom Schorn preferred the feel of the Zen Touch music player over iPod



ASSAULT ON THE IPOD

Apple's music players remain the top of the class, but some wannabes are hitting the right notes. **By Jay Greene**

IN JUST THREE YEARS, THE APPLE iPod has gone from music player to cultural icon. It has spawned a slew of would-be iPod killers, none of which has lived up to its billing. But among this year's new crop of wannabes are a few that are winning fans. "I wanted something more substantial. The iPod felt more like a toy," says Thomas Schorn, who raises snakes in Queen Creek, Ariz., and bought a Zen Touch from Creative. The iPod and the iPod mini rule, but rivals are getting better.

It takes just two words to explain iPod's success: look and feel. The circular gray click-wheel on its front lets you zip through thousands of songs, create playlists on the fly, and control the volume. You pay a lot for cool, though. Apple sells a version with 40 gigabytes of storage, enough for 10,000 songs, for about \$399. The 20-gigabyte version sells for \$299. The mini iPod, at 4-gigabytes, costs \$249. On Oct. 26, Apple leapfrogged ahead of the competition by announcing iPod Photo, for storing and

displaying photos in addition to songs.

You'd think if any company could displace Apple and the iPod, it would be Sony. After all, Sony pioneered the portable music business with its Walk-

man 25 years ago. But the more expensive Network Walkman hits a sour note when it comes to software. The biggest problem: Sony requires users to play songs only in its ATRAC format, a proprietary method for storing and listening to music. That means users have to convert any music already stored on their PC in the common MP3 format to ATRAC so it can play on the Network Walkman. In contrast, iPod and other portables play MP3s without modification. And even with a \$50 price cut on Oct. 31, to \$349, the Network Walkman is still \$50 more than the comparable 20-gigabyte iPod.

Trumping the Mini

CREATIVE HAS BEEN CHASING the iPod since its debut, but the new, 20-gigabyte Zen Touch, capable of storing 5,000 songs, isn't likely to help Creative gain ground. The player uses a new touch pad to navigate, and it feels more substantial—which appeals to fans like Schorn. Problem is, the Zen Touch is cluttered with an astonishing 11 buttons. Even with a battery that lasts more than 20 hours and a price tag that's less than the comparable iPod model, it's still not as attractive as Apple's player.

It turns out Apple's toughest competition is targeting the iPod mini. A bevy of pint-sized hard-drive music players are hitting the market. They all boast 5-gigabyte capacity, and one gets pretty close to the mini in coolness. That's Creative's \$249 Zen Micro. Like the iPod, Zen Micro has a touch pad to navigate through the system and has additional spots on its face that users simply touch to pause a song, fast forward to a new track, or jump to the main menu. The Micro trumps the mini with an FM radio and a removable battery.

iPOD RIVALS

Knockoffs of Apple's iPod and iPod mini are getting better



MODEL	PRICE/ STORAGE CAPACITY	THE GOOD, THE BAD, THE BOTTOM LINE
CREATIVE ZEN MICRO	\$249/ 5 GB	With good navigation features, a nice selection of colors, and a removable battery, the Micro is a winner
CREATIVE ZEN TOUCH	\$212-\$254 20 GB	Sound quality is excellent, but it's bulky and cluttered with buttons and on-screen options
DELL POCKET DJ	\$199/ 5GB	The price is right, but scrolling through songs is a slog, and there are too many menu options
RIO CARBON	\$204- \$249/ 5GB	The Carbon sports an attractive polished exterior, but some of the buttons are awkwardly placed
SONY NETWORK WALKMAN	\$349/ 20 GB	The 30-hour battery is great, but you have to reformat your MP3s to Sony's unique music standard to play them

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As cool as the iPod is, the rich lineup of accessories that have sprouted around it are just as nifty. Bose's SoundDock is one of the best. It's a great-looking speaker system, matching the iPod's white acrylics and curves. The speakers pump out tremendous sound, and it recharges the iPod while you listen.

so you don't have to toss the entire device or pay a fortune to have Apple replace the battery when it eventually gives out. And 5 gigabytes means 25% more hard drive space than the iPod mini. It may not look quite as elegant, but, feature for feature, the Micro stacks up very well.

The iPod mini rival that's been getting the most attention is the Rio Carbon. But the praise isn't entirely deserved. Like the

Zen Micro, the \$249 Carbon holds some 1,250 songs. But it doesn't include a hold switch to prevent users from inadvertently bumping a button that might stop a song or jump ahead to the next tune. The Carbon has a wheel, placed near the typical user's thumb position, to scroll through menus. Unfortunately, the most important button—the one that gets users back to the home screen—is awkwardly placed on the

side of the device rather than on its face.

Dell is also pushing hard in the mini market. It's selling a product that does the job at a lower price (\$199). But the Pocket D doesn't deliver nearly as well as its PCs. The 5-gigabyte DJ relies on a small, barrel-shaped wheel that juts out from the case to scroll through songs. This approach is too slow for traversing through long song libraries.

Most of Apple's competitors still have a long way to go. The large iPods remain the best gizmos for stockpiling all of your music, hands down. But if you're looking for a slimmer device to carry just 1,000 tunes or so, the iPod mini has some solid competition from Creative's Zen Micro. The Zen Micro may not become a cultural icon, but it gives you more for your money. ■

WHISTLING A DIFFERENT iTUNE

Apple isn't feeling heat just on the iPod front. Competitors are setting their sights on the highly successful iTunes online-music store, too. And while they don't quite measure up to iTunes, some of the big stores give consumers who don't own iPods plenty of satisfaction.

In establishing iTunes (itunes.com), Apple showed the same creative spirit that wowed consumers when it first conjured up the iPod. iTunes has lined up hundreds of great tracks that are exclusive to its service—songs from artists such as Elvis Costello and Alanis Morissette. And the store includes “fun mixtapes” of song selections from celebrities such as filmmaker Michael Moore and musician Fred Durst of Limp Bizkit. Be warned, though: iTunes sells songs only in its own format, AAC, designed to be played on the iPod.

Altogether, it's a package that

iTunes rivals have yet to match, although the combination of sites that sell songs in Microsoft's WMA format gives users a good alternative. These songs can be played on devices from Creative, Rio, Dell, and other makers.

Microsoft's MSN Music (music.msn.com)

is the best of this bunch. Its Map of Music lets consumers find tunes from artists in different regions of the country in each of the past five decades. The store offers more than 1 million songs, just like iTunes, including some artists, such as the Dave Matthews Band and AC/DC, that you can't find in Apple's store. The trade-off is that MSN has capitulated to demands by those artists to sell only their complete albums, and not individual songs.

A few other big online stores stand out. Napster (napster.com), MusicMatch Jukebox (musicmatch.com), and Virgin Group (virgindigital.com), which all sell music in the WMA format, have extensive libraries, and offer subscription services in addition to song sales. They let users pick through their entire catalogs for a flat monthly fee. And the RealPlayer Music Store (real.com/musicstore) sells music in its version of Apple's AAC format, so songs can be played on the iPod and WMA devices.

Apple will probably try to squelch that by tweaking software in iPods to make songs purchased from Real unplayable. Even so, one thing is clear: iTunes is no longer the only game in town.

—By Jay Greene

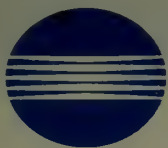
FACING THE MUSIC

Stores selling songs in Microsoft's WMA format are gaining ground

STORE	THE GOOD, THE BAD, THE BOTTOM LINE
MSN MUSIC	This store boasts a deep library and popular artists not found elsewhere
NAPSTER	The advantage here is smooth integration with Windows Media software
VIRGIN	There are many songs, but finding the good ones and grabbing them can be a pain
REAL PLAYER STORE	A good selection—and it works with most players



Data: CNET.com



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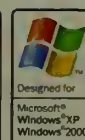
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REVIEW By Ronald Grover

TELEVISION THAT'S GOING PLACES

ADMIT IT: I LIKE baseball more than classical music. So when my wife and I recently attended a concert by our local symphony, I snuck out at intermission to catch the Los Angeles Dodgers' last-gasp effort in the National League playoffs. Tuning into the Fox Sports TV channel on one of Sprint's Samsung Multimedia cell phones, I watched the highlights of how the Dodgers had escaped elimination (at least for one more day).

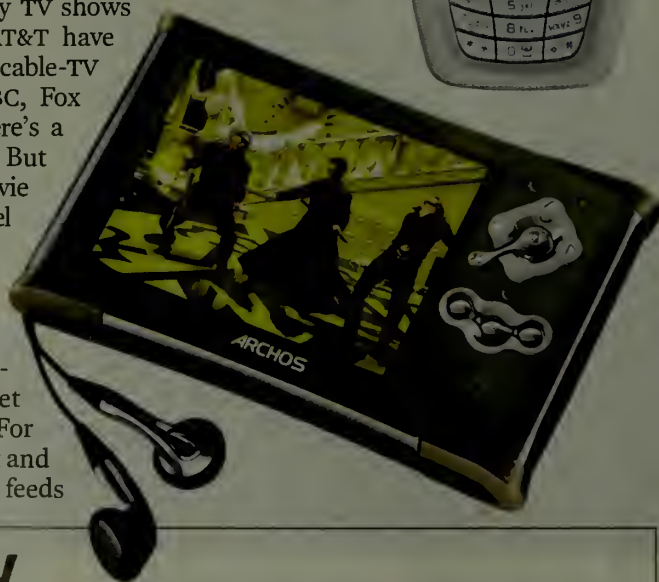
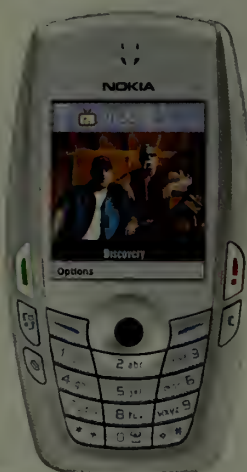
I can't imagine too many other occasions when I'd watch the tube on a tiny screen while I'm out and about. But the electronics industry is releasing a stream of handheld devices to deliver entertainment to folks on the go. Samsung, iRiver, and Creative offer portable gizmos that use Microsoft's Windows XP Media Center software to record and play TV shows and movies. Sprint and AT&T have phones with more than 20 cable-TV channels, including MSNBC, Fox Sports, and Discovery. There's a big gee-whiz factor here. But only hard-core TV and movie addicts—or those who travel a lot—are likely to find that they can't live without such toys.

There's no question that the technology is impressive and promises to get better down the road. For \$9.95 a month, both Sprint and AT&T offer "live" TV feeds

(there's a few seconds' delay) from MobiTV (mobitv.com), which streams TV signals over the Net. Sprint offers MobiTV on several phones, including lower-priced models; AT&T offers it on two, from Motorola and Nokia. Both providers also require you to pay up to \$25 a month

MOBITV Both Sprint and AT&T offer TV feeds streamed in over the Internet

ARCHOS AV400 Portable media players are handy, but screens are 4 inches or smaller



for data service to watch the tube. The TV picture isn't great—there are stops and starts, lengthy freezes, and problems syncing voice with picture. Because the picture is streamed at lower speeds than normal TV, talking heads on MSNBC's post-debate show were nearly impossible to follow, and baseball players on ABC News Now sometimes froze in mid-swing. MobiTV says faster streaming speeds will help solve the problems.

Small Scale

THOSE PHONES MAY be fine for train commuters and folks stuck in airports. But airplane travelers or kids in the back-seat will probably prefer portable media players, which are basically iPods for video. Most of them come with up to seven hours of battery life and a 20-gigabyte hard drive—enough, companies say, to store at least 40 hours of video. All display crisp digital pictures. One big liability: You're watching on screens no bigger than four inches.

In addition, recording can be a hassle. Creative's \$500 Zen Portable Media Center, like other Microsoft-sanctioned models, requires you to download or copy files from a PC with a TV card. That's a pain for most of us who haven't yet embraced Microsoft's convergence of TV and computer. Far easier to me are the \$549 Archos AV400 and the \$449 RCA Lyra Audio/Video Jukebox, both of which allow you to record shows directly from either the TV or your PC. Unfortunately, TV taping is in real time, meaning an hour show takes an hour to record. Of the two, the Archos is clearly superior—lighter, easier to navigate, and it comes with a remote that allows you to schedule recording. You can also can record DVDs, although you can't transfer them to another device.

I never got used to dealing with a tiny screen and earphones. And in fact, there are alternatives: You can buy a portable DVD player for about half the price—or just leave TV for the den. ■

TAKE-OUT TV

New phones and media players let you take your show on the road

CELL PHONES Sprint and AT&T offer TV channels on certain phone models for \$9.95 a month plus data fees, or short news and sports tidbits for as little as \$4.95. But the channels are limited—no network broadcasts—and the pictures are herky-jerky

VIDEO PLAYERS RCA, Archos, Creative, and others sell palm-size players for \$400 and up that can store hours of recorded shows. Some require a PC. Others let you copy from the tube. The video is sharp and seamless, but the tiny controls are hard to manipulate

SOMEONE IN H.R. HAS A DRUG PROBLEM.

If you work in human resources, you know that if an employee has a problem, it's your company's problem, too. Millions of parents have trouble talking to their child about illegal drugs – or what to do about an existing problem. Struggling with this can make it hard for employees to focus on meetings or deadlines at work – or even make it to work. Which can end up seriously affecting your company's bottom line.

But you can help them – and keep your company running smoothly. How? By providing your employees with the right tools to help them keep their kids drug-free. The @Work program

is a free, easy-to-implement resource that focuses on an employee's family by providing prevention tips, warning signs, strategies, and information on where to find help.



A broad range of small and large organizations – from private businesses to government agencies to nonprofits – have implemented the @Work program and have seen what it can do.

The one thing they all have in common? The shared knowledge that helping to keep an employee's family safe is – without a doubt – one of the most valuable benefits their company can ever offer. To learn more, visit theantidrug.com/atwork



BY ROBERT BARKER

Not Many Chinks In Symantec's Armor

The way you would rush to the dentist about a toothache. The way you would pay anything for bug spray if, some unlucky day, you found yourself lost in the Everglades. The very happy way you would tip a cabbie who returned a wallet you left in his car. That's how too many computer users feel about Symantec: dependent, desperate, grateful.

Maker of the Norton-brand Internet firewall and antivirus software programs, Symantec glories in the viruses, worms, Trojan horses, and other "malware" that can torment the rest of us. Demand is so strong that Symantec expects revenues in the fiscal year ending in March to surge 33%, to \$2.5 billion. It sees earnings per share jumping 44%, to \$1.54. After capital spending, Symantec generated cash of \$437 million in its fiscal first half—more than twice what it produced in the year-earlier period. "This machine will produce a ton of cash," Symantec's chief financial officer, Greg Myers, told analysts on Oct. 20. Small wonder, then, that at \$58 the stock is up 68% so far this year. Among software makers, only SAP, Oracle, and Microsoft boast higher market values.

Which makes me wonder: Is Symantec ready to crash? I doubt it. Its balance sheet is strong, with cash of \$2.5 billion and no debt. So are prospects for growth in demand for its software, which is due to include help soon in zapping the latest pestilence, spyware. Just the same, there are three realities about Symantec that investors need to keep in mind.

» **Slower growth.** Don't expect Symantec to see again the rapid rates of growth in sales (40%) and earnings per share (62%) that it has enjoyed in the past four quarters, which were a watershed period in consumer awareness of Web-borne computer viruses. As healthy as the business remains, during the next four quarters the year-over-year comparisons will be wicked, a reality that Symantec has been quick to note as it

ramps down the enthusiasm of Wall Street.

» Questionable growth.

Deducing the true growth rate of Symantec's businesses is tricky. Why? CEO John Thompson has made it clear a key to his strategy is growth by acquisition. In the past year, Symantec has bought several companies—antispam-software provider Brightmail, for example—but isn't disclosing how much in total revenue the purchased assets are delivering. It made an exception for its Enterprise Administration segment, which sells software for running corporate computer networks. It posted second-quarter revenue growth of 36%. Take out the contributions of two acquired units, however, and revenue sank 4%. This is no problem as long as the new units keep growing. But as too many investors have learned, every acquired asset that doesn't pay off gets written off. "Growth" can be a mirage.

» **Margin squeeze.** Symantec's mix of revenues is tilting to its retail business. In fiscal 2003, consumer products made up 41% of revenue; in the latest quarter, they contributed 51%. These sales come at a lower profit margin, and so Symantec's overall gross margin is edging down. You also can count on margin pressure from a host of rivals eager for a taste of Symantec's lush life. Despite its feeble attempt to patch security flaws with this year's Windows XP Service Pack 2, mighty Microsoft remains a clear and present danger.

Given these vulnerabilities, why don't I see Symantec as wildly overvalued? Compare it to Microsoft (table). Symantec can look forward to somewhat faster growth than the industry leader. Yet even at its recent highs, it is trading at an equivalent, reasonable multiple of free cash flow. Like it or not, each company has a grip on our wallets. ■

E-mail: rb@businessweek.com



Symantec vs. Goliath

COMPANY / SYMBOL	PRICE	FREE CASH FLOW PER SHARE*	PRICE-TO-FREE CASH FLOW RATIO	EARNINGS PER SHARE GROWTH**
Symantec (SYMC)	\$58.25	\$2.77	21.0	12.1%
Microsoft (MSFT)	27.63	1.29	21.4	12.0

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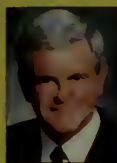


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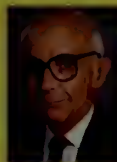
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Personal Business Inside Wall Street



BY GENE G. MARCIAL

NCR'S CASH MACHINES AND DATA SYSTEMS ARE IN HOT DEMAND.

CALIFORNIA COASTAL COMMUNITIES' ACRES MAY FETCH MILLIONS.

ARE BIG U.S. GROCERY CHAINS DROOLING OVER WILD OATS?

Going 'Ka-Ching' at NCR

ONE BRIGHT STAR in this bleak market is NCR (NCR), an old-line tech outfit that makes point-of-sale terminals, ATMs, and data-warehouse systems. Wal-Mart and Home Depot use its data systems. NCR shares bolted from 35 last December to 52 on Oct. 27. For six quarters, NCR posted happy earnings surprises as demand kept on rising. And on Oct. 12, it announced it would beat third-quarter estimates—prompting analysts to lift forecasts. In spite of the stock's steep rise, some pros see room to run. Matt Summerville of KeyBanc Capital Markets expects it to hit 65 in 12 months, rating NCR an “aggressive buy.” Servicing customers’ ATMs and cashier terminals is a field ripe for growth, Summerville says.

Customer service brings in a third of revenues but is still unprofitable. NCR says it now focuses on servicing customers that use products where the margins are high. NCR's ATMs and data warehousing systems should also yield “solid growth over the next several years,” he predicts. He has upped his earnings estimate for 2004 from \$1.27 a share to \$1.49, and for 2005 from \$1.95 to \$2. Richard Farmer of Merrill Lynch, which does business with NCR, has also raised his numbers—and rates the stock a buy. He sees sales of \$5.8 billion in 2004 and \$6 billion in 2005, vs. \$5.6 billion in 2003.



A Developer Sitting Pretty Beside the Pacific

SHARES OF California Coastal Communities (CALC) have doubled, to 20, this year as value and asset-play investors bought in. A builder and developer, Coastal's most valuable asset is 350 acres in Orange County, Calif., that overlook the Pacific Ocean and the Bolsa Chica wetlands: There are 208 acres north of the wetlands, 100 acres adjacent to Huntington Beach, and 42 acres of lowlands. Ben Segal, president of Winchester Capital Management, which owns shares, puts the property's value at \$350 million, or 35 a share. It's carried on the books at \$155 million. The value will be recognized, he says, once Coastal's plan to develop an environmentally friendly community with 379 houses in the Bolsa Chica area is approved by the California Coastal Commission. As part of the project, Coastal has agreed to sell,

for \$65 million, 103 acres of its Bolsa Chica land to the state Wildlife Commission, for an upland habitat. Segal says approval of Coastal's application for a permit to build the 379 homes could come in six months. He figures the shares are worth 30. Coastal is purely a play on assets and not on earnings, says Segal. In 2003, the company earned 27¢ a share on sales of \$56 million.

A QUICK DOUBLE IN VALUE



A Hungry Rival Could Swallow Wild Oats

WILD OATS MARKETS (OATS), a natural-foods chain, is having a wild year. Its shares tumbled from 15 on Apr. 12 to 5.67 on Oct. 27. Trouble started in August when Oats, which operates 100 groceries in 24 states and British Columbia, posted measly second-quarter earnings of 1¢ a share: The forecast was 10¢. Then on Oct. 25, Oats warned that it expects a third-quarter loss of 11¢ to 13¢—rather than the expected 1¢ profit. Fierce competition, particularly in California, torpedoed earnings. With the stock plunge, the buzz on the Street is Oats is a sitting duck for the likes of Kroger, the No. 1 grocer. “The stock is dirt cheap, and we are buying—as we expect Oats will be taken out,” says a hedge-fund manager, who did not want to be named. Another fund manager says Oats “will turn around—but before then, a larger company will grab it.” When the stock fell in August, four Oats insiders bought a total of 31,600 shares at an average price of 7.88 a share. Oats founder Michael Gilliland owns 8% of the stock. Its biggest shareholder, Wellington Management, with 15%, declined comment. Sonja Tuitele, investor relations manager at Oats, who bought shares in August, wouldn't comment on takeover talk. ■

GETTING GROUND DOWN



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

CANCER

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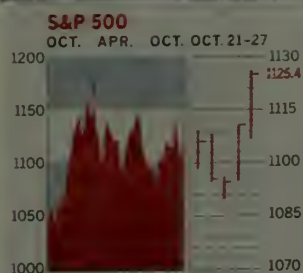


Bristol-Myers Squibb Company

Hope, Triumph, and the Miracle of Medicine

Personal Business Figures of the Week

STOCKS



COMMENTARY

After a rocky start to the week, equities came roaring back. Strong profit numbers from such bellwether stocks as Boeing and AmEx helped set the tone, with the Dow clawing its way back to 10,000. Also, better-than-expected housing sales and signs that crude-oil prices may be headed back down added to investor optimism, sending the broad market soaring.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	OCT. 27	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1125.4	2.0	1.2	9.1
Dow Jones Industrials	10,002.0	1.2	-4.3	4.1
NASDAQ Composite	1970.0	1.9	-1.7	4.6
S&P MidCap 400	601.6	2.6	4.4	12.0
S&P SmallCap 600	298.5	3.3	10.4	19.3
DJ Wilshire 5000	11,024.5	2.0	2.1	9.9

SECTORS

BusinessWeek 50*	652.4	1.4	4.9	9.9
BW Info Tech 100**	338.8	1.1	-3.3	2.7
S&P/BARRA Growth	545.2	1.7	-1.9	4.7
S&P/BARRA Value	576.1	2.2	4.4	13.7
S&P Energy	278.8	-0.3	24.4	40.0
S&P Financials	381.3	3.0	0.4	6.5
S&P REIT	134.2	2.2	15.9	23.1
S&P Transportation	222.0	3.0	9.9	16.7
S&P Utilities	133.2	3.2	12.5	19.5
GSTI Internet	158.4	4.2	9.5	9.8
PSE Technology	709.6	3.3	1.8	10.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	OCT. 27	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1227.8	1.0	4.2	20.0
London (FT-SE 100)	4630.1	0.3	3.4	8.9
Paris (CAC 40)	3678.4	0.3	3.4	11.2
Frankfurt (DAX)	3929.0	0.4	-0.9	11.7
Tokyo (NIKKEI 225)	10,692.0	-1.7	0.1	1.2
Hong Kong (Hang Seng)	12,838.7	-1.2	2.1	6.2
Toronto (S&P/TSX Composite)	8791.0	0.0	6.9	14.7
Mexico City (IPC)	11,517.7	4.0	31.0	45.7

FUNDAMENTALS

	OCT. 26	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.72%	1.72%	1.62%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.4	19.3	27.2
S&P 500 P/E Ratio (Next 12 mos.)*	15.5	15.6	17.6
First Call Earnings Surprise*	2.18%	2.17%	6.02%

*First Call Corp

TECHNICAL INDICATORS

	OCT. 26	WEEK AGO	READING
S&P 500 200-day average	1119.4	1120.0	Positive
Stocks above 200-day average	59.0%	54.0%	Neutral
Options: Put/call ratio	0.75	0.86	Positive
Insiders: Vickers NYSE Sell/buy ratio	4.28	4.51	Negative

BEST-PERFORMING GROUPS

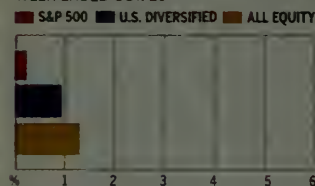
	LAST MONTH %	LAST 12 MONTHS %
Fertilizers & Ag. Chems.	20.0	Internet Retail 76.6
Airlines	16.1	Internet Software 75.3
Internet Software	13.7	Oil & Gas Refining 74.7
Instrumentation	13.5	Fertilizers & Ag. Chems. 72.0
Application Software	13.0	Steel 70.7

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Insurance Brokers	-33.1	IT Consulting -30.3
Multi-line Insurers	-11.1	Insurance Brokers -28.3
Health Care Supplies	-9.4	Airlines -23.2
Automobiles	-6.4	Semiconductors -21.2
Homebuilding	-5.8	Semiconductor Equip. -21.2

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	7.0	Natural Resources	44.6
Real Estate	5.2	Latin America	32.9
Communications	4.6	Real Estate	29.3
Technology	4.5	Utilities	23.1
LAGGARDS		LAGGARDS	
Health	-4.2	Technology	-6.2
Large-cap Value	0.1	Large-cap Growth	1.6
Large-cap Blend	0.2	Small-cap Growth	2.7
Pacific/Asia ex-Japan	0.3	Japan	2.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
American Heritage Grth.	16.7	ProFunds Energy Utr. Inv.	69.7
ProFds. Intnet. Utr. Inv.	14.5	ProFds. Wrld. Utr. Inv.	65.8
Jacob Internet	11.7	iShares MSCI Austria Idx.	63.9
Oppenheimer Real Asst. A	10.5	State St. Rsch. Gl. Rs. B	61.1
LAGGARDS		LAGGARDS	
ProFds. Phmcls. Utr. Inv.	-11.8	ProFds. Smidcr. Utr. Inv.	-43.0
AMIDEX Cancer Innvtns.	-9.0	GMO Emerg. Mkts. Qty. III	-40.5
ProFds. Hlthcre. Utr. Inv.	-8.7	Thurlof Growth	-38.2
Rydex Dyn. Vent. 100 H	-7.7	Ameritor Investment	-34.3

INTEREST RATES

KEY RATES

	OCT. 27	WEEK AGO	YEAR AGO
Money Market Funds	5.25%	5.25%	0.00%
90-Day Treasury Bills	1.91	1.83	0.95
2-Year Treasury Notes	4.28	4.16	4.27
10-Year Treasury Notes	4.09	3.98	4.28
30-Year Treasury Bonds	5.58	5.62	5.86
30-Year Fixed Mortgage †	5.58	5.62	5.86

†Barr'sQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
Taxable Equivalent	4.93	6.43
Taxable Equivalent	5.26	6.73

THE WEEK AHEAD

PERSONAL INCOME Monday, Nov. 1, 8:30 a.m. EST

September personal income is expected to have grown by 0.4% for the second straight month. That's based on the median forecast of economists surveyed by Action Economics. Consumer expenditures probably expanded by 0.6% in September, after holding steady in August.

PURCHASING MANAGERS' INDEX Monday, Nov. 1 10 a.m. EST

» The October factory activity index from the Institute for Supply Management probably inched up to 58.8%, from 58.5% in September.

FACTORY INVENTORIES

Wednesday, Nov. 3, 10 a.m. EST » Manufacturing inventories likely rose 0.3% in September, following a 0.5% gain in August.

PRODUCTIVITY & COSTS

Thursday, Nov. 4 8:30 a.m. EST » Output per hour worked over the third quarter probably

improved by 2.3%, after a 2.5% gain in the first period. Unit labor costs probably grew 2%, after a 1.7% increase in the prior quarter.

EMPLOYMENT Friday, Nov. 5,

8:30 a.m. EST » October nonfarm payrolls probably rose by 185,000 jobs, after a tepid gain of 96,000 in September. Factory payrolls most likely added 11,000 jobs, after a decline of 18,000 in the prior period. The jobless rate is forecast to have held at 5.4%.

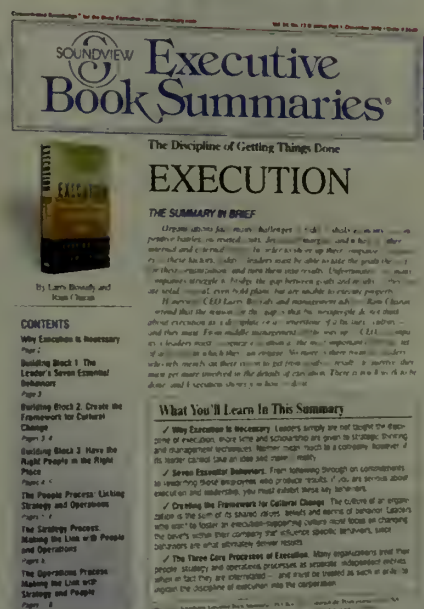
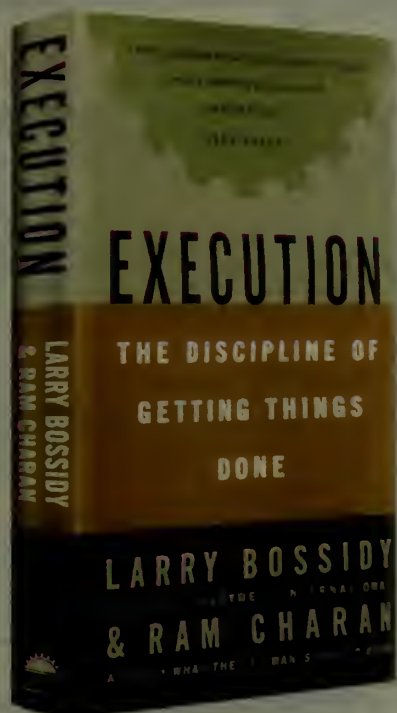
The BusinessWeek production index moved up to 228.9 for the week ended Oct. 16, a 12.3% increase from the previous year. Before calculation of the four-week moving average, the index climbed to 230.1.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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The Promise of Healthy Change

HEALTH SAVINGS accounts are the next big thing in medical care. As millions of Americans pick their medical plans for 2005, HSAs are showing up as one of their options. And that's only the start. By 2006 up to 75% of U.S. employers are expected to offer them since Corporate America sees HSAs as a major weapon in the fight against rising health costs.

We think HSAs have potential, especially for employees of large companies. The Bush Administration and conservatives in general strongly back HSAs, and in this partisan election season it's all too easy to evaluate them through a political lens. That would be a mistake. HSAs hold the promise of building a more consumer-driven market for medical services that could curb costs (page 88). They may not be the right option for everyone, but everyone should give them serious study.

HSAs allow employees to set up 401(k)-type savings accounts if they agree to buy high-deductible, low-premium catastrophic insurance plans. People can put pretax dollars up to the deductible into the account, invest it any way they want, use it for out-of-pocket medical expenses, and roll it over year after year if they don't use it up. And people can take their HSAs with them if they change jobs, just like their 401(k)s. Consumers are encouraged to find the best deals for lab tests, drugs, and specialist care. The idea is that individuals, because they see the real costs of their decisions,

will be less likely to choose unnecessary tests and treatments. Moreover, consumers will learn how to avoid overpriced and inefficient medical-care providers, thus bringing a long-overdue whiff of real competition in the health-care sector. The result: lower medical costs.

Certainly, there are risks to HSAs. The most serious is the possibility of splitting off better-paid, healthier people who join HSAs and pay relatively low insurance premiums from lower-paid, sicker people who don't join and therefore wind up paying much more for their traditional plans. There is also the risk that people will skimp on medical care to save their HSA cash and then end up landing in expensive emergency rooms and intensive-care units later on.

Companies can alleviate these problems by kicking in money to HSAs for lower-paid workers who don't earn enough to set aside savings. And employers could offer free preventive care, such as exams and shots, to make sure no one skimps.

HSAs shift part of the risk of rising medical costs off corporate shoulders onto those of their employees, much as 401(k)s have done with pensions. Forcing individuals to bear more risks is a significant issue. Yet with annual medical costs averaging nearly \$9,000 per employee, there's little doubt that U.S. corporations need to offload some of this burden. The sharp rise in medical-benefit costs in recent years has been one reason why U.S. companies are reluctant to hire new full-time employees.

Health savings accounts are not a panacea, but handled correctly, they could turn out to be a policy innovation that can make a difference, both for individuals and the country as a whole.

Globalization or Concentration?

ACQUISITIONS ARE A normal part of business life. But Lakshmi N. Mittal's bid to buy International Steel Group Inc., if it goes through, could be the start of a new stage in globalization. Mittal, an Indian-born tycoon with steel factories all over the globe, wants to add U.S.-based ISG to his stable to create the world's largest steelmaker. The deal could trigger a wave of additional cross-border mergers and consolidations until there are only a handful of large global players (page 47). The likely result: true global markets in steel and the reduction

or elimination of long-standing overcapacity in the industry.

With steel showing the way, the same thing could eventually happen in other industries with global overcapacity, such as autos, textiles, commodity chemicals, and even agriculture. In coming years, we could see country-spanning combinations in these industries that go far beyond, say, the merger of Chrysler and Daimler-Benz.

This new era of globalization could be a boon—if government oversight can keep up with the consolidation process. Such linkages are logical in a unified global marketplace and can lead to a more efficient and profitable manufacturing sector. As excess capacity is squeezed out, it will become more attractive to put new capital into factories.

But regulators in the U.S., Europe, and Asia will have to make sure that the process doesn't go too far. With too few global rivals, prices could head up again—bad news for both consumers and business customers. That objection shouldn't stop Mittal's bid, since the global steel market is still highly fragmented. But it could be a bigger factor in other industries, such as autos. Getting rid of global overcapacity is important, but not at the price of too much concentration.

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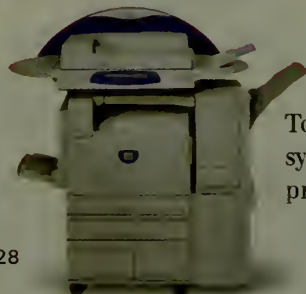
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WEB WATCH GUIDESTAR HAS WHAT THE IRS WANTS

SINCE 1999, the Web site GuideStar has bought copies of tax-exempt organizations' filings from the Internal Revenue Service and posted the information for public

based in Williamsburg, Va., takes scanned copies of tax forms and puts them into a searchable database, providing a more efficient way to pore over financials. Using it, *Boston Globe* reporters found a \$36 million private-jet expense tucked away on page 134 of a 191-page Florida foundation filing.

The government can use the help. In 2003, with limited resources and technology, the IRS audited only 5,754 of the nation's 1.6 million nonprofits. The U.S. government, says GuideStar President Robert Ottenhoff, "doesn't have adequate resources to oversee the sector."



review. Now, as the IRS ramps up its nonprofit investigations, *BusinessWeek* has learned the agency is buying back its own data to aid the effort.

GuideStar—a nonprofit

TAX RETURNS Buying data on nonprofits

The IRS did introduce electronic filing for nonprofits back in

February. But it says security concerns slow full implementation. Until then, the feds, like everyone else, can lean on GuideStar. —Jessi Hempel



PASSPORT REGS

A Tell-All Chip

IS BIG BROTHER LOOMING? In mid-October the U.S. gave contracts to four companies to develop passports with radio tags that contain more identity information, including biometric data such as facial recognition, in accordance with a 2002 border security law. The U.N.-affiliated **International Civil Aviation Organization** has set the standard for the chips, requiring them to be readable from a distance. The State Dept. wants them in all U.S. passports by the end of 2005. It's also demanding that other nations use the chips in their passports if they want to travel to the U.S.

Critics, concerned about privacy issues, allege "policy laundering": That is, to avoid criticism, U.S. officials tapped the obscure ICAO to set what some see as overly intrusive standards. "They chose a chip that can be queried remotely and surreptitiously," says computer security expert Bruce Schneier. If airport and border guards can read passports on the sly, so could other people with a radio chip reader—whether terrorists or identity thieves.

The feds say access to the chips will be only through a special reader. More worrisome to privacy advocates, Congress is talking about using such a chip in driver's licenses, just "as we feared," says the **American Civil Liberties Union's** Barry Steinhardt: "It would be an identity-theft nightmare." —John Carey

THE BIG PICTURE

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E-BANK NOTES

PAYPAL LOOKS LIKE eBAY'S BEST BUD

ON NOV. 22, eBay subsidiary PayPal will be left with a near monopoly on the \$8.2 billion e-auction payments market. That's when PayDirect, a joint venture of Yahoo! and HSBC Holdings, will close its doors. A similar service from Citigroup folded last year. Analysts don't see much of a threat from the few remaining players. "Just about every vendor of significance in this market has left," says Penny Gillespie, an analyst at Forrester Research.

That leaves parent eBay, which bought PayPal in 2002 for \$1.5 billion, sitting pretty.



WHITMAN Looking beyond auctions

PayPal is used in 66% of all consumer online auction transactions, says Jupiter Research, which sees the business growing 45%, to \$11.9 billion in transactions by 2009. PayPal, which collects fees from sellers, charges 30¢ per transaction plus 1.9% to 2.9% of the proceeds. Buyers don't pay anything. In the third quarter, the subsidiary's revenues rose 56%, to \$166 million, accounting for 21% of eBay's total sales.

A top priority for eBay CEO Meg Whitman is expanding PayPal beyond online auctions. On Oct.

25, PayPal began offering its services to Napster's digital music customers. And it's broadening its global reach. PayPal, currently offered in eight countries, will launch in more places in Europe in 2005.

—Olga Kharif

PETROL PATROL

BLACK GOLD Are these good times for Big Oil or what? The net profit of the five biggest shareholder-owned companies—ExxonMobil, BP, Royal Dutch Shell, ChevronTexaco, and France's Total—added up to a record \$20.2 billion in the third quarter. That's twice the 2003 profits of the biggest auto makers. The five majors account for roughly half the profits of the world energy sector. They have plenty of cash to crank up oil exploration but say they're limited by a lack of good prospects, equipment, and personnel. So a big share of the oil windfall is going to shareholders in the form of stock buybacks and higher dividends.

—Peter Coy



JUST SAYING NYET

NO BEER FOR YOU, BOYCHIK

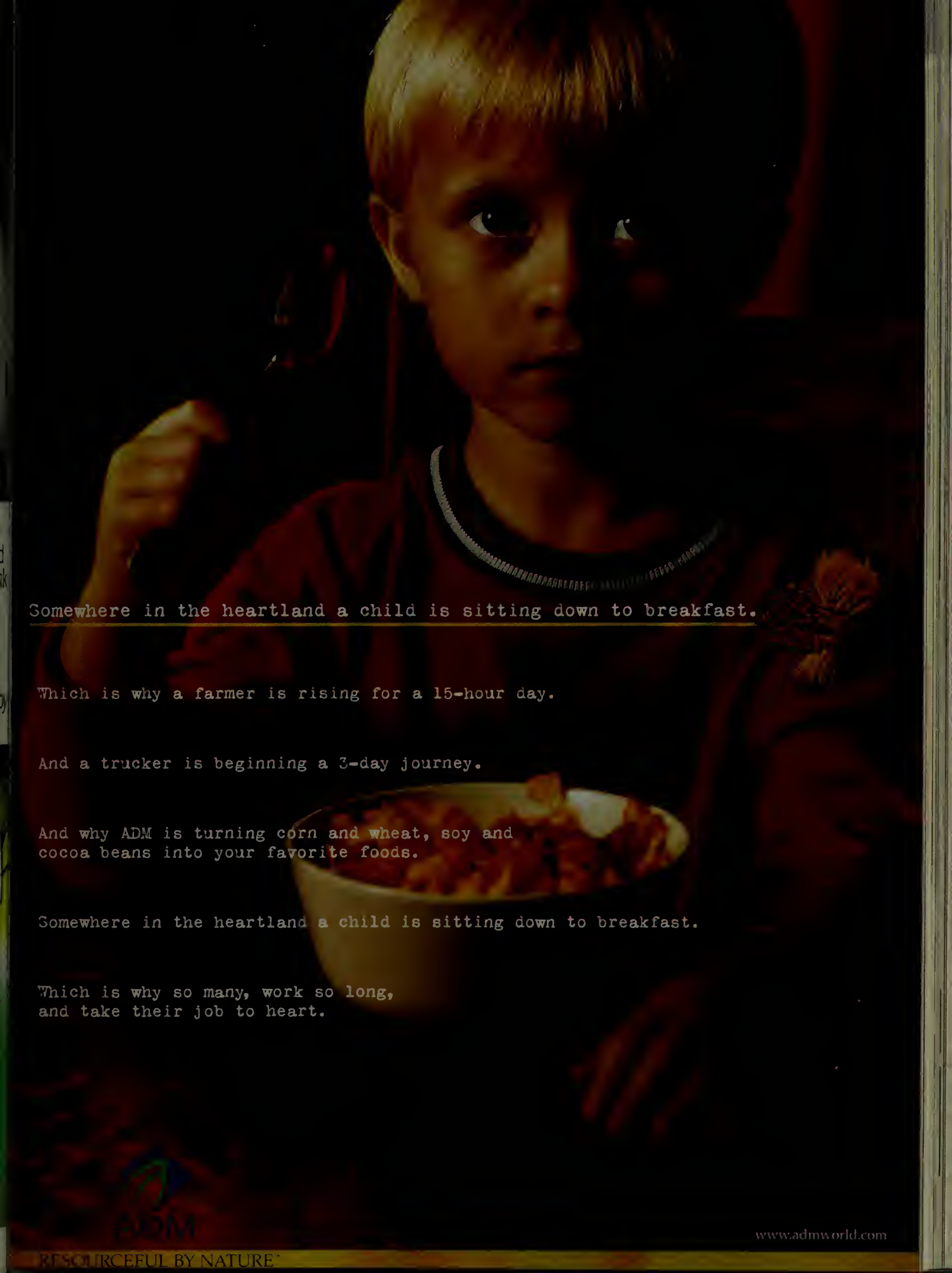
TO CRACK DOWN ON teenage alcoholism, the Russian Parliament on Oct. 30 approved a law banning beer drinking in stadiums, streets, parks, and other public places except restaurants. The ban comes after August rules forbade beer ads on TV before 10 p.m. and mandated health warnings.

Still, the \$6.5 billion beer market is set to grow 7% this year as more Russians adopt Western tastes. Local brewers say the vodka industry lobbied hard for the new law, since public drinking of vodka has been outlawed since Soviet times.

—Jason Bush

DRAWN & QUARTERED





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Which is why so many, work so long,
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FACE TIME

JAN BAAN



NEW DAY FOR A FORMER HIGH-FLIER

Jan Baan is back. The software-industry pioneer ousted from Baan Co., the former high-flier he founded, has emerged from five years in the shadows to announce his new company, Cordys. Like Baan, Cordys makes software for giant corporations. But while Baan made its name selling manufacturing software to the likes of Boeing, Cordys is focusing on software that knits together applications sold by hundreds of independent companies, from SAP to Siebel Systems.

Will Baan, 58, be welcomed with open arms? That's yet to be seen. He left the Netherlands-based Baan in 1998 after an accounting scandal. It has been sold twice since 2000 and has become a niche player.

With Cordys, Baan claims to have a leg up on rivals who have trouble getting all their old applications to work in concert. "We started from scratch, with no legacy," he says. Well, not exactly. There's that little taint of failure inherited from Baan Co.

-Steve Hamm

WEB WORLD

THE TV-PC MIND MELD SPEEDS UP

IF YOU THOUGHT browsing through 500 cable or satellite channels gave you finger fatigue, better hold on to your remote. Soon you'll be able to surf through thousands of Internet channels. Tech startups such as **DAVE Networks**, **Akimbo Systems**, and **TimeshiftTV** are taking a page from **TiVo** and rushing to create Net services that allow you to personalize your entertainment programming.

Viewers with Web access will be able to pay to download any available shows or movies to a hard drive. Some of the services require buying a set-top box, while others will record to a personal computer. Atlanta-based **DAVE Networks** expects to have 30,000 hours of programming available online by the January launch of its **Xport** receiver, which connects a TV and a broadband link. Users also

can upload their own content in peer-to-peer networks akin to **KaZaA** and **Grokster** on the music side, offering content for free or for a fee.

Think of it as "me" TV. Television has become the next frontier in the race to complete the digital home. **Microsoft**, **TiVo**, and even wireless carriers such as **Sprint** believe the next digital wave after music will be video downloads—everything from TV shows to movies to music videos.

Beginning next year, both major players and startups

will be competing heavily to satisfy video junkies' cravings for television anywhere.

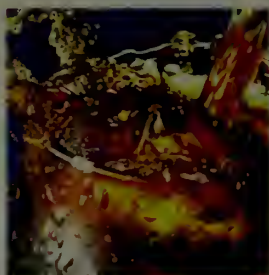
Analysts figure consumers will be willing to pay tiered fees, starting as low as \$4, to download premium content on a pay-per-view or subscription basis. But will adding more channels via Web downloads mean there'll be better stuff to watch? One of the keys to success will be how much new content studios and broadcasters choose to make available to online video customers.

-Cliff Edwards



BON APPETIT

FITTER OR FATTER? Americans are heftier than ever. But recent trends may suggest that a slimmer future for the U.S. is on the way. Popularity of some less-than-healthy favorites has fallen, causing anxiety at food and beverage makers.



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-1.8%



HAMBURGERS**

-3.1%



FRENCH FRIES**

-4.3%



COOKIES***

-6.7%

* per capita consumption since 1999 ** as a percentage of lunch orders since 1997 *** sales since 2001

Data: Beverage Marketing Corp., NPD Food World, Mint

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The Great Innovators

CELEBRATING



As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

The Seer From Seattle

MICROSOFT CORP.'S many critics will wonder what William H. Gates III is doing on a list of the greatest innovators of the last 75 years. The world's largest software company is often accused of piggybacking on the innovations of others rather than inventing itself. It's even accused of using its market clout to suppress creations from rivals.

Still, Gates deserves to be counted as a great American innovator—just of a different sort. More than anyone else, he can be credited with turning the disorganized PC tribes of the late 1970s into today's huge industry. Gates was among the first to recognize that all sorts of companies and products would be created if a computer's operating system and all the other software programs were separated from the hardware. The insight liberated innovation. Anyone anywhere could concoct new technologies, not just the engineers working on a new computer. "That was a doozy," Gates says. "We allowed there to be massive innovation on the hardware side and massive innovation on the software side."

Just as crucial, Gates understood the importance of owning the dominant operating system in this emerging industry. His moment of truth came in the summer of 1980, when IBM, in a rush to produce a PC quickly, was looking for another company to supply it with an operating system. Gates provided it and persuaded IBM to allow him to license the operating system to other computer makers, a move that both expanded the market exponentially and created a standardized platform for other companies to build upon. "He's always thinking about the competitive chess moves he has to make to make his products more successful," says Paul G. Allen, Gates's boyhood friend who founded Microsoft with him. "I don't know if anybody else back then had as broad a vision of what could be accomplished or

**Bill Gates's
insights helped
stimulate
innovation
in the fledgling
PC industry**

that kind of competitive juice."

Over the years, Gates and his engineers packed more and more capabilities into Microsoft's software, including Web browsing and multimedia functions. Those moves prompted antitrust investigations on two continents. But they also made it easier for people to buy and use Microsoft's software.

Ultimately, it may be that the lives Gates changes most will be many who are unlikely to ever use a computer. With his unsurpassed riches, Gates has become one of the world's leading philanthropists. His foundation, with a \$27 billion endowment, has given away \$4.7 billion in the past four years. But rather than just throwing money at problems, Gates is using the same kind of insight and tenacity that made him a business success to address some of the world's most vexing health issues. He created one fund, for example, that gives pharmaceutical companies multimillion-dollar financial incentives to develop a malaria vaccine, for which there had been little reward.

Now 49, Gates is at the point in his life where his legacy is beginning to take shape. He's certain to be remembered for the billions he amassed on his way to becoming the world's wealthiest man. And he'll likely be lauded for the billions he has given away to charity. And his legacy of innovation? It might be overlooked, but no one has left a more indelible mark on the PC industry than Bill Gates. ■

—By Jay Green

A building is no longer just a place you do business. It's a silent partner.

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Timing is everything in the fashion industry. What's in vogue one month is often out of style the next. Not surprisingly, fashion houses put tremendous pressure on suppliers to deliver the latest fabrics and textiles on time.

Perhaps nobody knows the demands of the fashion industry more than Marcel Banziger, the namesake and

preclearing U.S.-bound shipments and ensuring seamless same-day clearance. "With UPS, it's all in-house and the brokerage operations are much more qualified, responsive and can get quicker results," said Banziger.

UPS is also instrumental in helping Marcel Banziger stay on budget. Ever since UPS helped streamline his

Marcel Banziger: THE FAST-PACED FASHION WORLD MEETS THE FAST-PACED SUPPLY CHAIN.

founder of New York-based Marcel Banziger, Inc., a textile supplier to high-end designers like Oscar de la Renta, Halston and Bill Blass.

"Our business is time-sensitive and customers can't wait until tomorrow," said Banziger. "Our customers need fabrics for things like high-end fashion shows. A garment or a sample must meet the deadline. It's critical not to lose an hour."

But Banziger realized he was losing valuable time in transit due to customs delays caused by brokerage errors and oversights. To make matters worse, the failure to comply with customs regulations could potentially lead to hefty fines — up to 40 percent of the value of the imported merchandise.

By enlisting the help of UPS®, Banziger discovered he could streamline shipping operations and eliminate importing risks through smart solutions that saved time, controlled costs and even helped improve customer service. Right away, UPS saved his company at least a day in transit by reducing multiple carriers to one. UPS's customs brokerage services also came into play, speeding along the customs process by

supply chain, there have been significant cost savings and increased efficiencies. Also, there are no surprises in cost because static charges are known up front, making it easier for the small, ten-person company to plan ahead and manage cash flow more efficiently.

Largely an importer of textile goods, Marcel Banziger depends on timely shipments from places such as Italy, France, Switzerland, South Korea and Japan. UPS Import Freight Collect consolidates the company's bills and converts them to U.S. dollars, eliminating painstaking and costly currency conversions. To simplify things even further, Marcel Banziger uses one account number for all its import business.

"We're in the fast-paced fashion business with a continually changing product," said Banziger. "We have idea, color, and texture-driven products and our reputation for reliability in the market is good — absolutely good."

Marcel Banziger may be a small outfit, but by saving time and money it has managed to make a large impact in an industry where businesses come and go as quickly as last season's hemlines.



*"Our business
is time-sensitive
and customers
can't wait until
tomorrow."*



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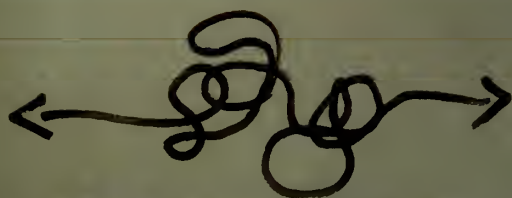
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A. BEFORE BROWN



B. AFTER BROWN

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Economic integration and co-dependency help nations avoid settling their disputes with the military option

—James W. Gabberty
 Pace University, New York

THE WOES OF U.S. DRUGMAKERS

JOHN CAREY'S commentary "A booster shot for vaccines" (*News Analysis & Commentary*, Oct. 25) implies that weak pricing and the need to invest in complex manufacturing procedures has led to the current flu-vaccine shortage. This is ironic, since most Americans seem to feel that we would all be better off if drug companies charged less for their products. If we successfully make drug companies lower their prices, maybe we'll also find other pharmaceuticals in short supply.

—Thomas Pisaturo
 Hancock, N.H.

WHY WOULD ANY pharmaceutical company whose management has half a brain want to produce, at great cost, a vaccine for anything today? All this industry gets for its costly pains is grief from the World Health Organization, the American Civil Liberties Union, and every other knee-jerk liberal in the world, as well as attorneys salivating to pounce on a company when a product, approved by our Food & Drug Administration, is later found to cause problems. Merck & Co., for example, created a drug for cur-

ing river blindness in Africa, from which it has never earned a nickel, having given it away (and probably even paying for shipping costs).

When will people learn that drugs do not come from the National Institutes of Health, nor any other governmental bureaucracy, but from capitalistic pharmaceutical companies that do the science and deserve to make profits? And then they're only permitted to charge what socialistic governments throughout the world will allow, forcing U.S. citizens to pay higher prices to cover the cheap prices paid by Europeans and Canadians.

—Judy Rosner
 Elmhurst, Ill.

A SILVER LINING IN THE OUTSOURCING CLOUD

SINCE THE LATE 1990s, both China and India have come "online," intertwining their economies with the West, notably the U.S. ("Jobs: The lull will linger," *News: Analysis & Commentary*, Oct. 25). China, for example, relies on the American consumer to fuel fully 50% of its export program, contributing to the gargantuan trade deficit. India, meanwhile, has been the recipient of tens of thousands of out-

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "The job market, unvarnished," (Editorials, Oct. 25), we erred in saying that the Federal Reserve believes that the Bureau of Labor Statistics payroll survey is the best available for calculating the unemployment rate. It is the BLS household survey data that are used to calculate the unemployment rate. The Fed believes the payroll survey is the best measure of employment growth.

A report on the holiday shopping season, ("Santa's feeling strapped this year," Marketing, Nov. 8), should have noted that Coach Inc. CEO Lew Frankfort is upbeat about his company's outlook and that he was referring to the general retail climate as "tough."

sourced jobs from U.S. businesses. Any fair trader will say that this is a good thing, since those economies will, the theory goes, eventually buy U.S. goods and services with net profits derived from trade relations with the U.S. Further, the resulting economic integration and co-dependency help nations avoid settling their disputes with the military option—witness the bulwark efforts by China and Japan to contain North Korea.

The more obvious line of reasoning is that IT itself may be the very place for job creation. As one interested reader witnessing the effects of globalization on the U.S. and abroad, I cannot help but be led to the same conclusion over and over again: The demand for knowledge workers will continue to rise sharply as more nations compete through international trade. Although thousands of U.S.-based computer programming jobs have been eliminated in the U.S., the demand for systems analysts, project managers, and systems architects continues to rise.

—James W. Gabberty
Pace University
New York

HOW MICROSOFT CAME OUT ON TOP

AS A GROUP product manager for a major PC product, one of my jobs was to work with both Digital Research and Microsoft to ship both CP/M and MS-DOS with our Intel-based machine ("The man who could have been Bill Gates," Information Technology, Oct. 25). So I had relationships in those early days with both Gary Kildall and Bill Gates. I was admired and dined by both. There were many times an evangelistic Gates would

about the future of PCs on the desktop. Kildall confirmed to me the basics of the huge misstep with IBM.

The key to the success of Microsoft, and MS-DOS, which focused on application-development languages at the time, was the tie-in between MS-DOS and specific hardware capabilities of the IBM PC. Both MS-DOS and CP/M bore remarkable similarities to RT-11, a minicomputer operating system of Digital Equipment Corp. By tying MS-DOS to the IBM PC, application providers' software products were locked into this combo. To make those same "killer apps" available on competing PCs was a major challenge for those companies. It was the introduction of Lotus 1-2-3 that created the start of the phenomena we know today.

—Kerry Bensman
Lafayette, Colo.

I HAVE BEEN a computing professional for more than three decades. I worked with both CP/M and DOS—PC-DOS and MS-DOS—and while the two products were similar, they were certainly not identical. CP/M was designed for 8-bit,

S-100 machines, which were significantly different from the IBM PC, both in function and architecture. The differences broadened as time went on, with DOS progressing much faster than CP/M. The Digital Research Inc. products for the PC never reached the levels of sophistication that were necessary and were never competitive.

This was in 1980, and IBM dominated all sections of the computer industry. I distinctly recall discussing with an IBM Fellow, who had been intimately involved in the PC project in Boca Raton, Fla., the issue of why IBM chose DOS rather than CP/M—which would have seemed the more obvious choice. He explained to me the IBM philosophy at the time: When choosing a supplier, IBM always chose one who would not have any control over the project or over IBM—in other words, the weaker company. IBM chose Microsoft to retain total control over the project. It failed in that objective.

Kildall was not "Bill Gates," not because of what anybody did to him, or even what he did not do, but simply because that is the way the cards fell—and be-



ause he did not react quickly and forcefully afterward.

—Mordechai Ben-Menachem
Ben-Gurion University
Beer-Sheva, Israel

WILL BROADBAND INTERFERE WITH EMERGENCY COMMUNICATIONS?

NOW THAT'S PLUG-AND-PLAY" (Upfront, Oct. 25), about the new Federal Communication Commission rules facilitating broadband over power lines (BPL), gives the false impression that there is no downside to this technology. In fact, both the FCC and the National Telecommunications & Information Administration acknowledge that BPL poses a risk of causing interference to licensed radio services such as fire and police frequencies, Federal Emergency Management Agency backup circuits, shortwave broadcasts, aeronautical mobile communications, amateur radio, and several broadcast TV channels.

By not imposing more stringent safeguards in its decision, the FCC fails in one of its primary responsibilities—to protect licensed wireless users from interfer-

ence. Other less invasive technologies exist to promote broadband Internet access. One must ask which is more important: effective public service and emergency communications capability, or a refrigerator that can send e-mail over the power line when it's low on ice?

—Wayne Greaves
San Patricio, N.M.

DEFINING WHAT'S FAIR IN BROADCASTING

IN "PUBLIC AIRWAVES, private purpose" (Editorials, Oct. 25), you implore broadcasters to "show a modicum of fairness" in selecting their programming. The message is that "fairness" requires acting deliberately against one's personal convictions. You chastise the CEO of Sinclair Broadcast Group for running a partisan documentary that he likes and for refraining from airing an ABC *Nightline* show that he found offensive. You suggest that he ought to do the reverse: airing what he despises and not showing what he finds commendable. Privately owned companies should be free to broadcast whatever pleases their owners. Real "abuse of pow-

er" comes from those who would have the government dictate program content.

—Barry A. Liebling
New York

WHAT KIND OF CONCENTRATION CAMPS?

"THE BEST B-SCHOOLS" (Cover Story, Oct. 18) has a sentence that describes a student writing about visiting a "Polish concentration camp." Everyone who knows history knows what the writer had in mind, but it is definitely not the correct phrase to use in a leading international magazine. There were no Polish concentration camps in World War II. There were only concentration camps set up by Nazi Germany in occupied Poland. They should be referred to as German concentration camps in Poland or Nazi Germany concentration camps in Poland.

—Jakub Krawczyk
London

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A Geek's Walk on Wall Street

MY LIFE AS A QUANT Reflections on Physics and Finance
By Emanuel Derman; Wiley; 292pp; \$29.95

Indecisive, introspective, awkward, and sometimes morose, memoirist Emanuel Derman comes across like a character in a Saul Bellow novel. He wallows in loneliness after leaving his home in South Africa to earn a PhD in theoretical physics at Columbia University. Later, he obsesses over leaving pure physics to

do applied research at Bell Laboratories. Then he punishes himself with guilt when he abandons physics entirely to work on Wall Street. Although he succeeds as a math-savvy "quant" at Goldman, Sachs & Co., he continues to ponder whether markets can really be understood. "We are still on a darkling plain," he writes toward the end of his new book. "If you are a theorist you must never forget that you are traveling through lawless roads where the local inhabitants don't respect your principles."

That sense of being an intruder in outlaw territory lends an intriguing mood to Derman's *My Life As a Quant*, a literate and entertaining memoir of his two-stage career—in physics and then financial engineering. Wall Street looks quite different from a nerd's-eye view: "Geeks were fair game," Derman reflects. Once, a chief trader who passed between him and a fellow quant "winced, clutched his head with both hands as though in excruciating pain, and exclaimed, 'Aaarrgh-hhh! The force field! It's too intense! Let me out of the way!'"

As one of Wall Street's leading quants, Derman did throw off some intense gamma radiation. He worked at Goldman from 1985 until 2003 except for one year at Salomon Brothers. At Goldman, he moved from fixed income to equity derivatives to risk management, becoming a managing director in 1997. He co-invented a tool for pricing options on Treasury bonds, working with Goldman colleagues Bill Toy and the late Fischer Black, who co-invented the Black-Scholes formula for valuing options on stocks. Derman received the industry's "Financial Engineer of the Year" award in 2000. Now he directs the financial-engineering program at Columbia University.

Derman failed at what he really wanted, which was to become an important physicist. He was merely very smart in a field dominated by geniuses, so he kicked around from one low-paying research job to another. "At age 16 or 17, I had wanted to be another Einstein," he writes. "By 1976... I had reached the point where I merely envied the postdoc in the office next door because he had been invited to give a seminar

in France." His move to Wall Street—an acknowledgment of failure—brought him financial rewards beyond the dreams of academic physicists and a fair measure of satisfaction as well.

In the tradition of the idiosyncratic memoir, *My Life As a Quant* is a grab bag of the author's interests. It quotes Schopenhauer and Goethe while supplying not one but three diagrams of a muon neutrino colliding with a proton. There is a long section on the brilliant and punctilious Fischer Black; a glimpse of physicist Richard Feynman; and an embarrassing encounter with finance giant Robert Merton, who sat next to the author on a long flight (Derman treated him rudely before realizing who he was).

Derman's mood seems to vary from bemused on good days to sour on bad ones. The chapter on his postdoc travels is titled "A Sort of Life"; his brief career at Bell Labs, "In the Penal Colony"; his tenure at Salomon Brothers, "A Severed Head." Pre-IPO Goldman Sachs comes off as relatively gentle yet stimulating. He writes: "It was the only place I never secretly hoped would crash and burn."

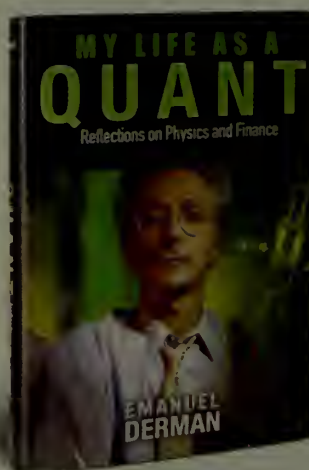
At times, his awkwardness is so extreme that it's funny. Here's how he failed to work up his nerve to ask a Columbia professor to be his adviser: "Every time I saw him I smiled; every time I smiled he bared his lips back at me with greater awkwardness." It got so painful that he began to flee whenever he saw the prof coming.

The most challenging part of the book—and for techies, probably the best—is Derman's detailed explanation of trading tools he developed. The Black-Derman-Toy model, from 1986, allowed trading desks to come up with prices for Treasury bond options based on math rather than guesswork. In 1993 he and Goldman colleague Iraj Kani invented an options-pricing method that improved on an aspect of Black-Scholes—its incorrect assumption that the volatility of options is unvarying. They deduced the "local" volatility of a

conventional option at each possible stock price and at each moment up to expiration. That information could then be used to price exotic options more accurately.

As it turned out, both inventions had limitations in practice, but Derman accepts that. The theoretical purist finds a measure of contentment in contributing to the imprecise world of finance—"intuiting, inventing, or concocting approximate laws and patterns." It ain't $E=mc^2$, but as he recognizes, it may be the best anyone can hope for. ■

—By Peter Coy



Derman turned away from physics to find success at Goldman

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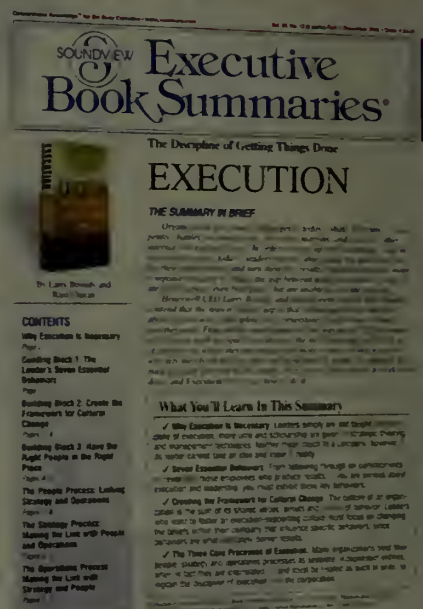
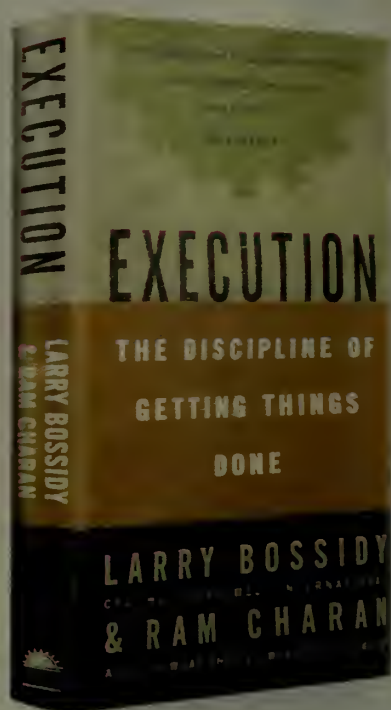
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BY STEPHEN H. WILDSTROM

The Music Mess: Advantage, Microsoft

Imagine buying a CD at Best Buy only to discover that it won't work on the CD player you bought at Circuit City. Absurd as it sounds, this sort of situation is the rule rather than the exception in the world of legally downloaded music. This maze of incompatible standards is a threat to online services such as Apple Computer's iTunes Music Store.

The situation is both baffling and infuriating. My iPod can play all the MP3s I rip from CDs or pull from KaZaA (if I used it), but when it comes to legal downloads, it works only with the iTunes store. The Roku SoundBridge that connects my stereo to my computer's stash of digital music can play everything in my iTunes library that I digitized myself—MP3s and the like—but not iTunes Music Store purchases. Similarly, other players handle only music bought from a specific service.

No wonder the market share of legal music downloads remains tiny compared with sales of CDs and the traffic on music-swapping services such as KaZaA. Both let you play your music wherever you want. Record companies insist on using technology to limit the number and types of copies buyers can make of downloaded songs. But the problem isn't the restrictions—it's the incompatibilities. Apple uses a digital-rights management (DRM) system called FairPlay, RealNetworks uses one called Helix, and Microsoft has just introduced a DRM known as Janus.

IT'S PUZZLING THAT THE INDUSTRY doesn't see how hard this is on consumers. Apple has chosen an isolationist course. It supports only FairPlay in its products, and it has been unwilling to license other companies either to build FairPlay-enabled players or to sell FairPlay-protected songs. Hewlett-Packard sells iPods co-branded with Apple, but it's not clear whether Apple will enter broader licensing deals. RealNetworks, as befits the smallest competitor, is eclectic, promoting a system called Harmony that supports players using its own Helix as well as Microsoft's Janus. It also sells songs for the iPod using its own, unlicensed version of FairPlay.

Microsoft holds the high cards in this game. Much as I hate to see the colossus of Redmond end up dominating yet another market, I believe that is going to happen, and given the current state of affairs, it may be the best outcome for consumers. Microsoft doesn't make player hardware, and



MSN Music is a tiny part of its business. The company makes money selling the Windows Server 2003 software required to distribute music or video in Windows Media content, so it profits by having the technology as widely embraced as possible. To promote that, it offers favorable, often royalty-free, licensing of Windows Media technology to music and movie studios and device makers.

When Windows Media 10 and Janus were released in early October, Microsoft took a self-serving step that

simplifies things for consumers. It created a "PlaysForSure" logo for sites that sell Windows Media music and devices that play it. In theory, PlaysForSure music you buy from sources that include Napster, Musicmatch, and Wal-Mart Stores will work on any PlaysForSure player, including products from Dell, Creative, iRiver, Gateway, and newcomer Virgin Electronics.

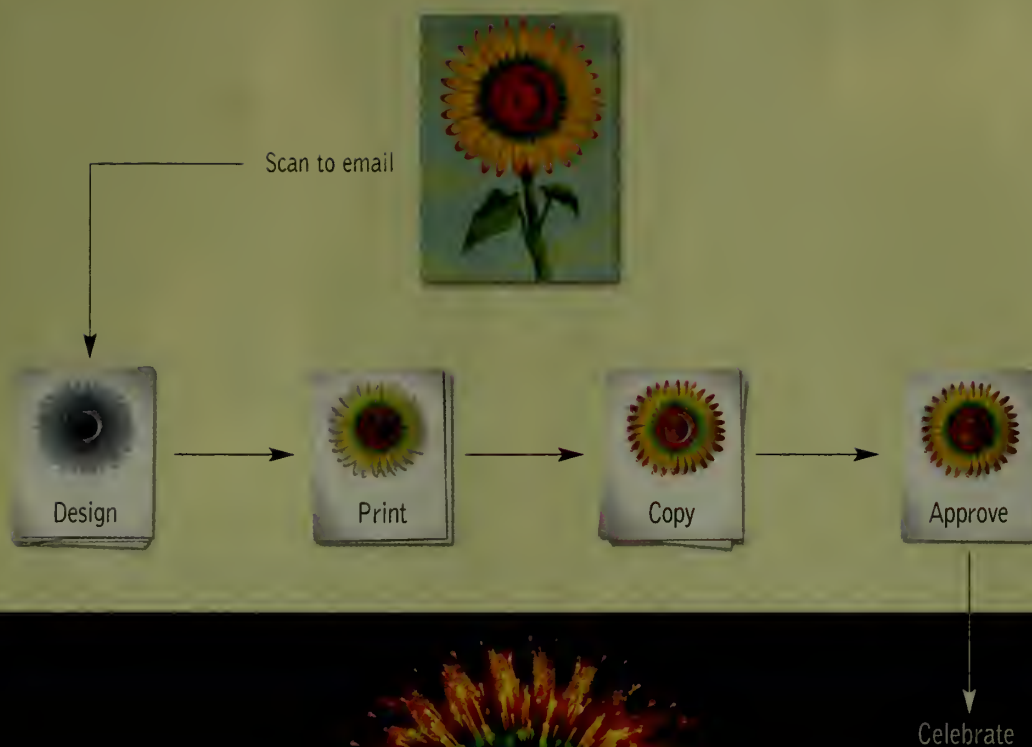
None of these players is as easy to use as an iPod, these

Web sites aren't as easy to use as the iTunes online store, and no rival can match Apple's brilliant marketing. But the gap is narrowing. Virgin Electronics, for one, is part of an empire with proven marketing ability, especially in selling music.

In the end, what consumers care about is getting the music—and in the not-too-distant future, the movies and video—they want and having it play without hassles on the device of their choice. Microsoft's big-tent approach offers a way out of this morass for everyone, except perhaps Apple. ■

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BY JEFFREY E. GARTEN

Uniting, Not Dividing: A Blueprint for Bush

It's hard to imagine a more polarizing election season than the one that has just ended. According to Yale University historian John Gaddis, we may have to go back to America's colonial days to find so nasty a Presidential race. Going further, Columbia University's Alan Brinkley says the vitriolic campaign reflects the deep divisions that have been widening since at least

2000, and he feels that such differences may be unbridgeable for a long time.

The pessimism of these distinguished historians is understandable, especially given the powerful victory of the Republican Party in the White House, in Congress, and in state capitals. Now President George W. Bush faces a choice: He can use his Republican majority as a battering ram to get his way, widening national political divisions even more. Or he can make a special effort to forge bipartisan cooperation, as other Presidents have done.

I hope Bush chooses the latter course, however unlikely it seems in the aftermath of the election. I believe that without cooperation, none of the big issues—not Iraq, not homeland security, not the fiscal mess, not the lackluster jobs situation, not health care—can be effectively addressed.

WHAT, THEN, COULD BUSH DO to maximize his chances of successfully dealing with these problems? He could make some key Cabinet appointments from the ranks of the Democratic Party. Yale's Gaddis points to two precedents. In the highly charged political environment of World War II, Democratic President Franklin D. Roosevelt picked Henry L. Stimson, a prominent Republican, as Secretary of War. Years later, amid Cold War tensions, Democratic President John F. Kennedy chose Republican Douglas Dillon as Treasury Secretary. What about the President asking Senator Joseph Biden (D-Del.) to be Secretary of State or former Senator Sam Nunn (D-Ga.) to take over Defense?

President Bush could select one or more high-profile Democratic emissaries to help with particularly difficult challenges abroad. Gaddis recalls how FDR asked Republican Wendell L. Willkie, the man he defeated in the Presidential election, to go overseas as a special ambassador to demonstrate bipartisan support for the nation's foreign policy. What about asking former President Bill Clinton for help in resolving the Israeli-Palestinian conflict? Or former U.N. Ambassador Richard C. Holbrooke to oversee a new global nonproliferation effort?

The White House could establish bipartisan groups to examine critical challenges—such as the financing of the upcoming retirement of 70 million baby boomers or the

ramifications of the escalating trade deficit and foreign debt. An excellent precedent: In 1982, President Ronald Reagan established a bipartisan commission under Alan Greenspan, then a private citizen, to fix the imbalance between payroll taxes and future Social Security benefits. The President didn't want options; he asked for a consensus. As a result, an agreement was hammered out and then implemented.

President Bush also could identify important bipartisan initiatives that are ready to be enacted into law. Case in point: Former U.S. Housing & Urban Development Secretaries from both parties, Democrat Henry G. Cisneros and Republican Jack Kemp, have recently produced an impressive blueprint for a national housing policy for low-income citizens.

Bush needs bipartisan accord to address the big issues effectively

The President could appoint a moderate to the Supreme Court when the first vacancy opens up. Almost nothing else would better signal the President's intention to unite the country rather than further divide it. Bush could build bridges to centrist leaders from both parties. This group includes Democrats such as Senator Hillary Clinton (D-N.Y.), Michigan Governor Jennifer Granholm, and Senator-elect Barack Obama (D-Ill.). It includes Republicans such

as Senators Chuck Hagel (R-Nebraska) and Richard Lugar (R-Ind.), as well as Massachusetts Governor Mitt Romney.

A disunited America, says Columbia professor Brinkley, not only will fail at home but also will be unfit to deal in the complex global arena. I know it's a long shot to believe that President Bush will move the nation toward what historian Arthur M. Schlesinger Jr. once called "the vital center," given his recent record and his new mandate. But since President Bush has the luxury of never having to run again for office, and since I think he cares about his legacy, I fervently hope that he will at least try to bring the country together. ■

Jeffrey E. Garten is dean of the Yale School of Management (jeffrey.garten@yale.edu).

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BY JAMES C. COOPER & KATHLEEN MADIGAN

Corporate Profits: The Squeeze Is Already On

Rising compensation and low pricing power will combine to shrink margins

U.S. ECONOMY

The stock market voiced its approval on the Nov. 3 news that President George W. Bush won re-election. However, investors may have been reacting as much to the lifting of election uncertainty as to the Bush victory per se. Now, the focus can shift back to economic fundamentals. The most important: Forces already in

play will put some strain on corporate earnings in 2005.

Chief among them is the squeeze from compensation growth, including benefits, which is coming at a time of low pricing power and slower growth in productivity. That means profit margins are set to shrink over the course of next year, and that would be the case no matter who's in office. That's not to mention moderating economic growth, higher borrowing costs as interest rates rise, less favorable global factors, new rules requiring expensing of stock options, and the expiration of a key depreciation allowance.

To be sure, the trend in corporate profits may seem insignificant compared with other economic challenges in the coming year. Boosting employment opportunities, battling the huge federal deficit, and narrowing the massive current-account gap in an orderly way will all be top economic issues at the White House (page 38).

But Bush II's success at managing these risks will depend greatly on an economy that is growing at a solid pace. And any new squeeze on margins and earnings could go a long way in determining overall demand, job growth, inflation, interest rates, and the attractiveness of U.S. financial assets to foreign investors.

UNDER THE BUSH ADMINISTRATION, corporate profitability has enjoyed a heady run, reflecting the uplift from both the business cycle and certain tax policies. After falling in 2001, operating earnings per share for the companies in the Standard and Poor's 500-stock index skyrocketed to a peak yearly increase of 26.3% in the first quarter of 2004. Now, although profits for the third quarter are expected to be up some 16% from a year ago, the earnings slowdown has begun (chart).

Profits will have to battle the business cycle and the waning stimulus from past low interest rates and tax cuts. Real gross domestic product grew 4.4% in 2003, and growth is averaging 3.8% so far in 2004, including the Commerce Dept.'s report of a 3.7% gain last quarter. In 2005, however, real GDP growth will likely slow close to its long-run trend of about 3% to 3.5%, especially given that higher energy costs will cut into demand this winter.

Meanwhile profit margins, the amount earned from each unit sold, appear to have topped out at a high level,

and from now on are set to shrink. As a result, 2005 will present a double whammy for earnings. Lower margins place more pressure on businesses to increase earnings from stronger top-line revenue growth. But as the economy slows, faster growth in revenues is unlikely.

Margins are in a vise partly because productivity growth has slowed sharply. After averaging a bracing 5.7% per quarter in 2003, output per hour will struggle to an

average 2% gain this year, especially in light of a weak third-quarter showing.

Although job growth has not been strong, payrolls and hours worked are no longer falling as they had been for nearly three years. A modest pickup in job growth will cut into productivity gains.

Plus in the coming year, labor compensation is unlikely to slow further—and may well grow faster. Even tepid job growth means the labor market is tightening, albeit at a gradual pace. With the unemployment rate down nearly a percentage point since June, 2003, businesses have to compete more for workers with the skills they need. And that generally leads to upward pressure on pay.

THAT MAY ALREADY BE HAPPENING. Hourly wages and salaries, as measured by the employment cost index, increased at a 3.5% annual rate in the third quarter, the largest quarterly rise in a year. In addition, a survey by Watson Wyatt Worldwide, the human resource consulting firm, shows that while companies are raising the bar for incentive pay, they plan merit raises averaging 3.4% in 2005, up from 3% in 2004. The upshot is that unit labor costs are turning up after a three-year downtrend. Unless prices grow just as fast, margins must fall.

But so far, reports of increased pricing power have been spotty across industry groups and concentrated in the business-to-business markets for materials and semi-finished products. Excluding the gyrations in energy and

PROFITS START TO SLOW



food prices, core producer prices for intermediate goods are up 7.8% from a year ago, but core finished goods prices have risen only 1.9%. That's up from near-deflation a year ago, but it's no faster than in the late 1990s, which were a time of falling profits and margins.

Further downstream, consumer prices remain under pressure. Price increases outside of fuel and food actually slowed last quarter after a small pickup in the spring. The core price index for personal consumption expenditures rose at an annual rate of 0.7% from the second quarter to the third, the smallest quarterly gain in 40 years. Over the past year, the inflation rate is only 1.5%. In 2005, global competition, the chief factor holding back pricing power, will continue to limit price hikes domestically.

One possible plus for labor costs next year is that companies may get a handle on their medical expenses even before Congress and the White House sit down to discuss what to do about health care. The growth in benefit costs slowed for the second quarter in a row. Benefits, which surged at a 10.9% annual rate in the first quarter, grew 7.1% in the second quarter and only 4% in the third (chart). A big reason why: The Labor Dept. said that health-care costs rose 7.3% over the past year, down from a 10.1% yearly pace this time last year.

OTHER FACTORS WILL ALSO WEIGH on earnings growth in the coming year. Net interest expense in the corporate sector began to rise last year, and it will accelerate now that business borrowing is picking up and the Federal Reserve is hiking rates. After falling steadily

for more than three years, commercial and industrial loans have been in a clear uptrend since spring.

Cash flow will also take a hit in 2005 as the "bonus depreciation" allowance, which was a provision in the 2002 tax package, expires at the end of 2004. Estimates suggest the allowance will add some \$60 billion to profit

this year, but earnings will lose that lift in 2005. Companies will also have to begin counting stock-option grants as an expense against current revenues.

Outside the U.S., the earnings climate will be less attractive as well. Overseas operations are sure to suffer as global growth recoils from the impact of higher oil

prices. Moreover, the trade-weighted dollar is now higher than it was at the start of the year. Unless the greenback weakens, foreign earnings will not get much of a benefit when they are translated back into dollars.

To be sure, Corporate America will still make money in the coming year. Plus, companies are sitting on a cash hoard of historic proportions. But earnings are set to slow, perhaps considerably. How businesses and Wall Street react to that will make the policy decisions of the second Bush Administration all that more important. ■

THE RISE IN BENEFIT COSTS BEGINS TO EASE



BRITAIN

Pop Goes the Housing Bubble

THE BANK OF ENGLAND appears to be getting its wish—and then some. Five quarter-point hikes in interest rates, to a three-year high of 4.75%, have pricked Britain's housing bubble and cooled off the economy. In fact, the air is coming out faster than expected, and economic growth has slowed sharply.

Preliminary data show that real gross domestic product in the third quarter grew by a slim 1.5% annual rate from the previous quarter, far below the second quarter's 3.7% gain. Last quarter's pace, which included the largest decline in industrial output in nearly three years, was the slowest in 1½ years. In August, the BOE predicted 3.6% growth in both the

third and fourth quarters.

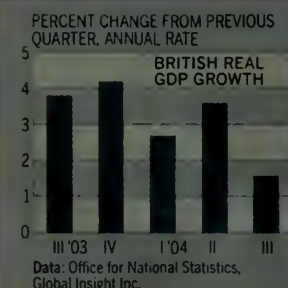
Last quarter's sudden slowdown reflected more than just weaker industrial output. By all measures, Britain's five-year housing boom, which saw house prices double, has come to an end. The BOE reported that mortgage lending in September posted the smallest increase since April, 2003, and that mortgage approvals fell for the fourth month in a row.

Meanwhile, after growing 25% in 2002 and 15% in 2003, house prices have all but stopped rising. The housing boom and jump in home equity loans have left households with more than 1 trillion pounds (\$1.8 trillion) of debt, equivalent to nearly 95% of Britain's GDP.

Signs of weaker consumer demand are already cropping up. Although official retail sales data through September remain solid, consumer confidence has fallen, and surveys of retailers show weaker readings than earlier in the year. Economists generally expect slower household spending to lead to another subpar gain in real GDP in the fourth quarter.

For 2005 growth, much depends on how fast the house-price bubble deflates. Most analysts expect a gradual adjustment. But as consumer spending slows, other sectors will have to take up the slack. For now, capital spending is on firm footing, amid healthy corporate cash flow, but the extent of the slowdown in household spending could affect future outlays and hiring. Also, with global growth cooling due to higher oil prices, export growth may ease. Clearly, the BOE has set the stage for slower growth next year. ■

THE ECONOMY COOLS OFF





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*Claims compared to a conventional diesel bus on an urban schedule.

**Based on Ward's segmentation and 2004 model year EPA estimated mpg city and highway leaders.

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SPECIAL REPORT ELECTION 2004

THE NEXT FOUR YEARS

With a clear mandate, Bush will push his ambitious conservative agenda. But hostile Dems and tight budgets will make it a struggle



TRIUMPH!
The President
declares victory and
calls for healing

BRUSHING OFF A SPUTTERING Iraq War, an economy struggling to create jobs, and a hard-hitting challenge from John Kerry, George W. Bush roared to a convincing victory on Nov. 2, besting his Democratic rival 51% to 48% and paving the way for four more years of conservative Republican rule. Although Democrats took pains to nominate an Establishment contender and decorated Vietnam War vet, and Kerry reprised some of Bill Clinton's New Democratic doctrine, Bush's answer was simplicity itself:

He drowned out Kerry's middle-class economic message by making terrorism and national security the dominant motifs of the race; then he undermined his foe's credibility by painting him as an ultraliberal flip-flopper who would hasten the day when terrorists would again rain havoc on America.

The fight was brutal, yet Bush prevailed by a surprisingly large margin. The President anchored his win by capturing the big swing states of Florida and Ohio, the bedrock of his 2000 victory. As *BusinessWeek* went to press, he seemed assured of 279 electoral votes, while Kerry had wrapped up 252. An additional seven were too close to call.

NEW VOTERS ON BOTH SIDES

DEMOCRATS HOPED TO carry the day with a registration drive of epic proportions. But Republicans neutralized that blitz with a grassroots surge of their own. Key demographic blocs targeted by the White House, including evangelical Christians, married women, and Hispan-

ics upped their backing of Bush from 2000—gains that offset declining support from moderates, independents, and young voters.

To appreciate Bush's achievement, consider the obstacles in his path: Despite four tax cuts, the pre-election economy was 940,000 jobs short of recovering from the losses of the 2001 recession. Sky-high oil prices are sapping growth, and consumer confidence declined in the final four months leading up to the election. The Dow Jones industrial average meandered all year, stuck near 10,000. And analysts scored a hyperkinetic Bush 0 for 3 in the fall debates against a confident, Presidential-looking Kerry.

As for Iraq, the President's defining metaphor for leadership, the U.S.-led occupation looms as a disastrous counterpoint to the 3½-week blitz that toppled Saddam Hussein's forces. After more than 1,100 U.S. casualties, what Americans mainly have to show for Operation Iraq Inc. is a seething Iraqi insurrection, uncertain prospects for free elections, and

allies who are buckling under the threat of kidnappings and murders.

Bush's clear-cut victory puts him in a strong position to push ahead with the next leg of his ambitious conservative agenda. But given the deep divisions rending the nation, it would be a stretch to interpret his triumph as an overwhelming endorsement of anything concrete—much less “stay the course” entreaties on Iraq, a deficit-be-damned drive for more tax cuts, or a dimly perceived “Ownership Society” that proposes partial privatization of Social Security and aims to replace the employer-based



BUSH'S BOLD SECOND-TERM AGENDA

The President has a big wish

IRAQ

» Coalition forces will step up assaults against insurgent strongholds, hoping to improve security and pave the way for elections as soon as next January.

COST \$70 billion requested for 2005.

PROSPECTS If a semblance of stability is achieved—and anti-American theocrats don't dominate those elections—the stage could be set for a semi-dignified withdrawal starting in 2006. If Iraq descends into further chaos, forget the dignified part—all bets are off.

TAX CUTS

» The dividend and capital-gains tax cuts pushed through in his first term are set to expire in 2008, while cuts in individual income tax rates end in 2010. Bush's first domestic priority in a second term will be to fight to make them permanent.

COST \$1.9 trillion over a decade.

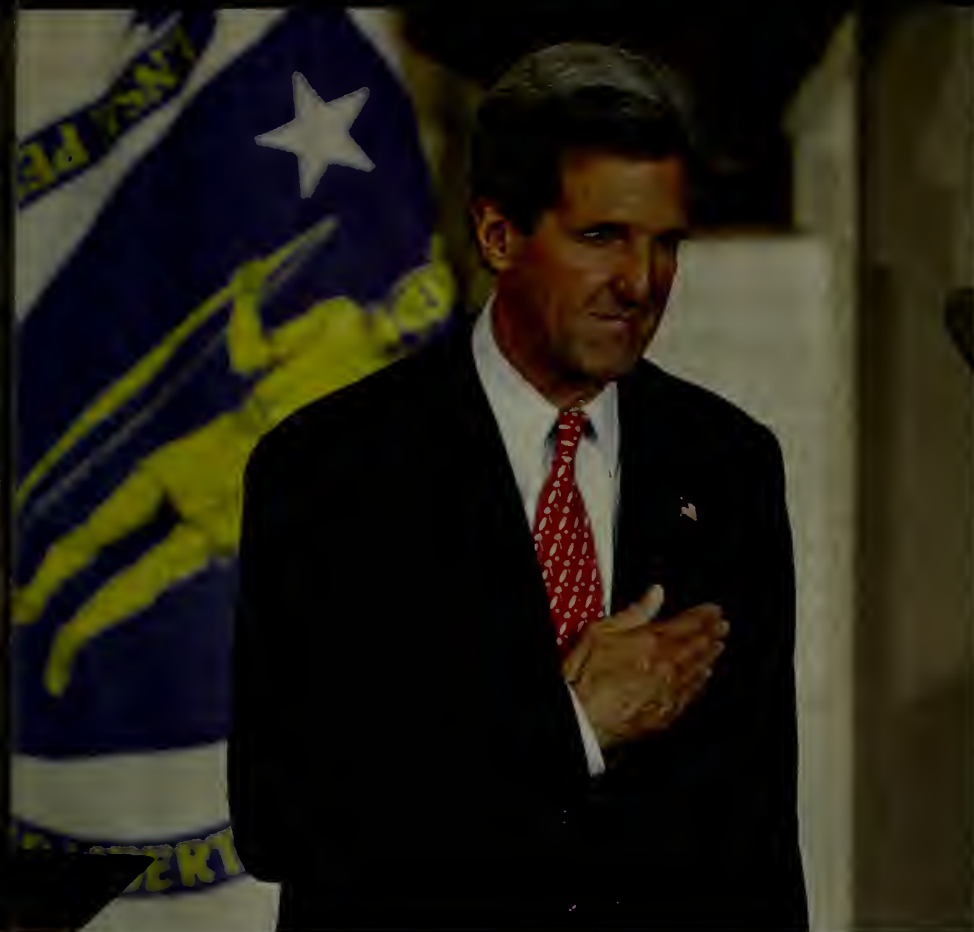
PROSPECTS With Republicans in charge of the House and adding to their margin in the Senate, Bush should get his way.

TAX REFORM

» Bush wants to overhaul the tax code to make it simpler and more favorable to savings and investment. He'll need to decide whether to push for fundamental change, such as a consumption tax, or simply to focus on making filing easier and slowing the spread of the alternative minimum tax.

COST The White House will try to keep changes revenue neutral, though an AMT patch could cost \$600 billion over 10 years.

PROSPECTS Dicy for anything big, since business losers could unite to kill changes.



BLOODIED
Kerry
concedes
in a graceful
exit

a showdown with Iran (page 52), kicking off a sweeping drive for free-market reforms of domestic programs, and—given the chance—naming conservative anti-abortion jurists to the Supreme Court.

"If Bush were like Thomas Jefferson—which he is not—he would issue a statesmanlike call for reconciliation," says Rutgers University political scientist Ross K. Baker. "Instead he'll interpret his win as a strong sign of support for things like private Social Security accounts."

Exactly, say exultant Bushies. "We need to charge out of the box with a mandate to be bold," says policy director Tim Adams. By snaring five Democratic Senate races in the South and upending Senate Minority Leader Tom Daschle in South Dakota, the GOP padded its Senate margin by four (page 46). Such a psychological blow can be useful. Says ex-White House economist Lawrence B. Lindsey: "Some Democrats will probably rethink whether obstruction is the best strategy."

But for economic and political reasons, the crucial first year of a new Bush term will differ from the Texan's 2001 storming of Washington. Then, Bush dominated the debate with two splashy domestic goals: stimulative tax cuts and bipartisan education reform. With a projected 10-year surplus of more than \$5.6 trillion, he had plenty of cash to use and made rapid headway on his agenda. The September 11 terror strikes only added to his stature. Bush used his new clout to ram tax cuts and more tax cuts through Congress.

In 2005, Bush will commence Act II after running a campaign that downplayed home-front concerns to revolve around his wartime vision. Many voters have only

health-insurance system. Hemmed in by hostile Democrats, a busted piggybank, and a lack of national consensus on his conservative reforms, Bush faces tough struggles on Capitol Hill.

What the President mainly won on Election Day, experts say, is a chance to revise the script of 2000, when he ignored a contested victory to govern more from the conservative than the compassionate end of the spectrum. He also gained an opportunity to reach across party lines and bind the nation's wounds. "The country remains clearly divided," says Richard M. Kovacevich, chairman and

CEO of Wells Fargo & Co. His hope is that "President Bush would decide to bring the country together and be President of all the people."

FULL SPEED AHEAD

WILL BUSH SEIZE the moment, morphing from partisan to conciliator? Not likely, longtime Bush-watchers suspect. While the President may mute some base-stoking rhetoric for a while, when Congress convenes in January he's expected to dig in his spurs and charge. That means pushing ahead with a troubled Iraq venture, possibly upping the ante in

there's a wide divide between what's desirable and what's doable.

SOCIAL SECURITY

Bush favors allowing younger workers to use a portion of their payroll taxes to set up individual investment accounts to finance their retirement. He still hasn't said how he will finance the transition or whether he will require workers to opt for lower benefits in return.

POSITION COSTS \$1 trillion to \$2 trillion.

PROSPECTS Tough. Even with strong presidential backing, any proposal to fund the program with massive new borrowing will spark controversy on Capitol Hill.

THE DEFICIT

» After running up record deficits in the first term, Bush has vowed that he'll cut the \$415 billion deficit to about \$250 billion in five years, mostly by holding down discretionary spending. But his plan to make the tax cuts permanent, the staggering costs of homeland security and Iraq, and the need to fix the AMT make this a daunting task.

PROSPECTS Only another stock-market boom could bail Bush out.

ENERGY

» In his first term, the President failed to persuade Congress to enact his pro-production energy plan. But with oil trading at near-record levels, he will redouble his efforts.

COST \$14 to \$30 billion.

PROSPECTS Chances of success are higher because of consumer ire over soaring gasoline and home-heating-oil prices. But they could founder if the GOP continues to insist on drilling in the Alaskan Wildlife Refuge.

the vaguest idea of what his domestic program looks like. That, plus the prospect of piling up \$3 trillion in deficits and growing distress with Bush's fiscal stewardship gives the President less running room to push for his wish list.

Typically, though, that list does not lack for ambition—and the price tag could be huge. Among the priorities: a costly experiment with private Social Security accounts, a \$2 trillion plan to make previously enacted tax cuts permanent, a difficult tax-simplification drive, expanding the No Child Left Behind Act to high school kids, reviving a stalled energy plan, tort reform, and, oh yes—a pledge to cut the deficit in half.

Some business leaders wonder if all this is achievable and whether the priorities are right. "Personally," says Edward M. Liddy, chief executive of Allstate Corp., "I think doing something about

health care [should be] higher on the agenda than reforming Social Security." Adds R. Jarrett Lilien, president and chief operating officer of E*Trade Financial Corp.: "The deficit is a serious issue, and I don't know whether cuts in spending or tax increases" are needed.

SUPREME COURT STRUGGLE

NO ONE, OF COURSE, is selling a leader as determined as George W. short. But in reality, a reelected Bush could be slowed by his own personal energy crisis. He'll be preoccupied by Iraq and constrained on the domestic front, his maneuvering room limited by budget shortfalls and threats of Democratic trench warfare. "Some of Bush's first-term success was due to Democrats' willingness to work with him," notes Marshall Wittmann, a senior fellow at the centrist Democratic Leadership Council. "Next year, Democ-

rats are going to be ornery, and they'll stay ornery for a long time."

An immediate trigger for Capitol Hill chaos could come over the Supreme Court. With Chief Justice William Rehnquist ailing and several of his colleagues likely to retire soon, Bush could soon walk into a national brawl over the judiciary. Democrats would go to the mat in a fight to preserve *Roe v. Wade*, affirmative action, and other liberal touchstones—which is why some business leaders are hoping against hope for calm on the kulturkampf front. "I hope cooler heads prevail," says James R. Houghton, CEO of Corning Inc. "It would be very divisive to see *Roe v. Wade* overturned."

A poisonous court fight could shatter the consensus on key pieces of legislation. Says Michael Franc, chief legislative analyst at the conservative Heritage Foundation: "A lot of political capital

THE ADMINISTRATION

Team Bush, Again... With a Few New Faces

Never known as a man who says "I goofed," George W. Bush made headlines in the second Presidential debate when he reluctantly admitted: "I made some mistakes in appointing people, but I'm not going to name them." This President rarely sacrifices a besieged ally—as long as his or her fealty to Team Bush is not in question. So the President who won reelection by proclaiming his stay-the-course determination isn't likely to clear the decks. K Street lobbyists and Republican operatives mostly are speculating about who's too burned out to soldier on.

Any shifts will probably be concentrated in the foreign policy team. After their mammoth clashes over Iraq policy, Defense Secretary Donald H. Rumsfeld and Secretary of State Colin L. Powell appear to be playing a game of chicken: Neither wants to be the first to walk and leave the field to his rival. But insiders now are betting that Rumsfeld will be first to go. Rumsfeld, 72, may not be ready to leave just yet. He doesn't want to be remembered for failing to foresee the Iraqi insurgency or for fostering the climate that led to abuses at Abu Ghraib prison. He also is eager to finish his modernization of the military. But blunders in Iraq have undermined confidence in him to the



RICE Secretary of State, if Powell leaves?

point where he will have to go fairly soon, GOP advisers say.

A leading contender for the Pentagon chief's job would be National Security Adviser Condoleezza Rice, who spearheaded a White

House effort a year ago to take command of the faltering U.S. occupation. The assumption in Washington is that she wants out of her post as head of the National Security Council. A Soviet affairs expert, oversaw budgets of academic programs as provost of Stanford University prior to joining the Administration. But running a sprawling government bureaucracy would test her mettle. Other candidates include Sean O'Keefe, head of National Aeronautics & Space Administration, and Navy Secretary Gordon England.

With Rumsfeld's star in decline, Powell could reclaim lost ground. But senior advisers say he's fed up with the turf battles and is likely to stick around for long either. Rice would be a front-runner for Powell's post. Bush insiders also are talking up two recently appointed ambassadors, John C. Danforth to the U.N. and John D. Negroponte at the U.S. mission in Baghdad, for the top State job.

Homeland Security Secretary Tom Ridge is believed to be headed for the door after a tough slog in a post with little authority. U.S. Secretary Asa Hutchinson may well get the job, unless Bush prefers to reward former New York City Police Commissioner Bernard Kerik, who campaigned vigorously for him. Kerik's business partner, former New York Mayor Rudy Giuliani, would appear a shoo-in, but he's looking for a higher-profile post as a spring-board for a possible White House job in 2008.

The economic team is the only place where Bush has ever cleaned house. But that's not going to happen this time. Any departures likely to be voluntary. Treasury Secretary John W. Snow, who has been in the job less than a year, is a tireless traveling salesman for

will be consumed. And it will displace other issues for an extended period of time."

Even if Bush sidesteps a nasty judicial spat, when it comes to the rest of his agenda, he's raring to hit the ground running. The President's inclination, aides say, is to ignore political and budgetary impediments and seek cosmic fixes for monumental problems. So he'll plunge ahead on the goal of making his tax cuts permanent and will challenge Congress to re-vamp Social Security by approving personal investment accounts. Bush also is intrigued by the notion of restructuring the tax code, an idea that's both big and controversial. It's a hefty load. Says a lobbyist with ties to the White House: "Bush can't do all three; he probably can't do two."

AND THE WINNER IS...

	POPULAR VOTE	STATES WON*	ELECTORAL VOTES**
BUSH	51%	30	279
KERRY	48%	20	252

* Includes DC ** 270 Electoral Votes needed to win. Data as of 8:00 PM, Nov. 3. Iowa (7 electoral votes) still too close to call. Minor candidates account for remainder of popular vote. Data: Associated Press

Business reps expect one of the first bills Bush sends to Congress to be one seeking to make the 2001 and 2003 tax cuts permanent. True, those rate reductions and capital-gains and dividend cuts don't expire until '08 and '10. And even some tax-cut activists, such as Grover G. Norquist, president of Americans for Tax

Reform, wonder why there's a rush. But Bush considers the tax cuts a legacy to preserve. Other GOP pols, looking to the 2006 midterms, want to force Senate Democrats into casting no-on-tax-cuts votes in lockstep opposition. While GOP moderates blanch at the cost, odds of passage in a GOP Congress are decent. Says Joe M. Allbaugh, Bush's campaign chief of staff in 2000: "The President will put every bit of personal capital he has into making those tax cuts permanent."

Next up will be a bid for Social Security revisions. Republicans think redirecting some payroll taxes into worker-held investment accounts can raise the retirement system's puny returns. Wall Street will throw its own lobbying clout behind the plan, which would mean new funds for the stock market—and a bonanza for money managers.

But first the White House will have to



FRIEDMAN New staff chief?



FELDSSTEIN Eventually, the Fed?



GONZALEZ To the High Court?



ADAMS Next stop, NEC?

economics and stays relentlessly on-message. He'll probably stick around. But Wall Street veteran Stephen Friedman, director of National Economic Council for two years, wants to move on from that behind-the-scenes post. The leading candidate to succeed Friedman is Tim Adams, Bush's campaign policy director and a former top Treasury aide. Adams, a pragmatist rather than an ideologue, is said to favor tax reform and deficit reduction to boost the savings rate. Federal Reserve Chairman Alan Greenspan isn't expected to leave before his term expires in January, 2006. If he does, the leading candidate to succeed him is Harvard University professor Martin S. Feldstein, a respected economist who would be tough on inflation. At the Office of Management & Budget, Director Joshua B. Bolten may be asked to move over to the White House. Bolten has the inside track to succeed White House Chief of Staff Andrew H. Card Jr. After four years in the

grueling post, Card wants out. Bolten would retain a major role in budget policy, especially if he's followed at OMB by deputy Joel D. Kaplan. Commerce Secretary Donald L. Evans is said to want to move back to Texas. That could mean an opportunity for Mercer Reynolds III, the Republican entrepreneur from Ohio who chaired the Bush-Cheney reelection effort and helped the Prez shatter fund-raising records.

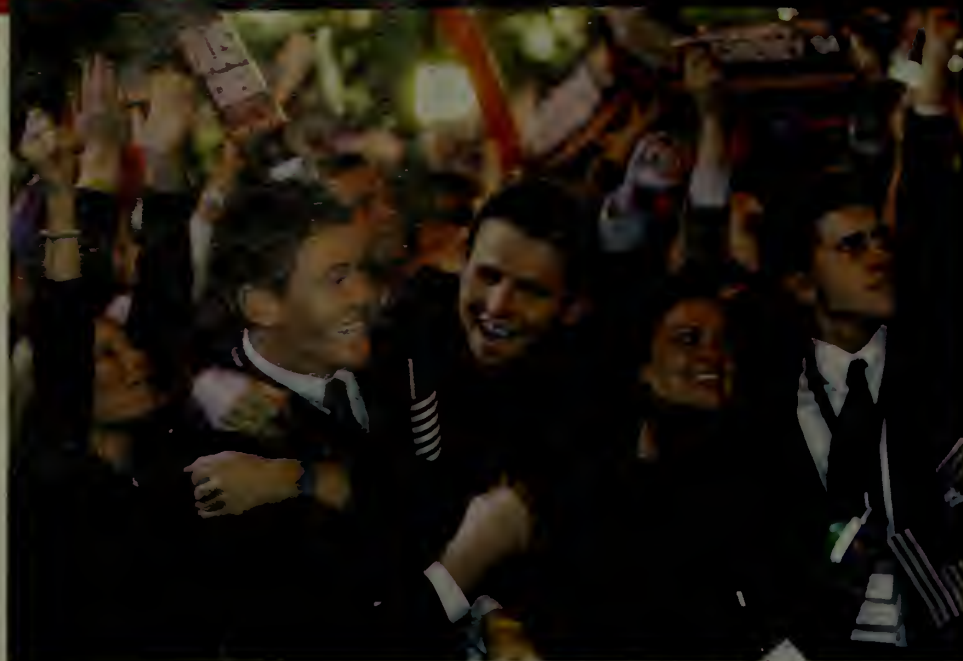
Among domestic posts, the biggest headline-grabber will likely be the departure of Attorney General John Ashcroft, a too-controversial darling of conservatives. The favorites to succeed him start with Larry D. Thompson, Ashcroft's former deputy, who recently became general counsel at PepsiCo. Inc. Thompson, a distinguished lawyer respected by both Democrats and Republicans, would become the first African-American AG. White House Counsel Alberto R. Gonzales also is on the short list. Or Gonzales could realize

his dreams of becoming the first Hispanic on the U.S. Supreme Court.

Indeed, even before Bush sealed his victory, speculation was mounting on Court appointments. Chief Justice William H. Rehnquist, who is being treated for thyroid cancer, may soon retire. Besides Gonzales, contenders for the nation's top court include J. Harvie Wilkinson III and J. Michael Luttig, both judges on the U.S. Court of Appeals for the Fourth Circuit; Edith H. Jones, also a federal appeals court judge; and Thompson. With a stronger majority in the Senate, Bush may test whether he can promote hard-line conservative Justice Antonin Scalia to the Supreme Court's center seat.

Scholars say that a second-term shake-up can energize a Presidency. But Bush isn't the type to make wholesale changes. Familiar faces could be the rule for four more years.

—By Amy Borrus, with bureau reports, in Washington



decide what restructuring should look like. How big should the accounts be? Proposals for a carve-out range from 2 to 6 points of the 12.4% Social Security payroll tax. Another key decision: Will younger workers who use private accounts be required to accept smaller benefit checks to offset the cost?

The biggest quandary is funding the transition. The problem is, the existing system is pay-as-you-go, so current workers' payroll taxes fund their retired parents' benefits. If workers divert taxes into private accounts, where will the money come from to pay for tomorrow's elderly? The gap: up to \$2 trillion over a decade.

The Bush crew, which won't raise taxes, seems to have settled on some form of borrowing to cover the cost. But adding \$200 billion a year to the feds' hefty financing needs may not sit well with the bond market. And that illustrates Bush's toughest task: persuading Republicans to sign on to a plan that can easily be skewered by Dems. "The President strongly believes in this," says ex-Congressional Budget Office Director Rudolph G. Penner. "But it will be extremely difficult."

TAKING ON THE TAX CODE

MOST POLITICIANS FACING fights as tough as preserving tax cuts and overhauling Social Security would call it quits right there. Not Bush. He will take a page from Ronald Reagan's playbook by creating a blue-ribbon panel to explore simplifying the tax code and rendering it more conducive to savings and investment. Under consideration: everything from a consumption-based income tax to a Reagan-style effort to cut loopholes and cut rates.

Many Republicans, including House

Majority Leader Tom DeLay (R-Tex.), want to replace the revenue code with a national sales levy. Others support a flat tax that would set a single rate on all income. But those proposals are already generating business opposition. Retailers and small businesses worry that a big new sales tax would chill consumers. And corporations, many of which pay little or no tax, are not enthusiastic. In the end Bush may get only small-scale changes. In the balkanized atmosphere of Washington, "it's tough to come up with a big policy that has any chance of enactment," says former GOP Representative Vin Weber.

If he wants to be more incremental, Bush will have another vehicle to push tax reform—a patch for the Alternative Minimum Tax. The AMT is a backup tax system that hits 3 million mostly middle-class families by eliminating deductions for state and local taxes and for children. Unless it's fixed, it will hammer 30 million taxpayers by 2010.

In recent years Bush and Congress have agreed to stopgap repairs. But the price tag is exploding, and a long-term fix would cost at least \$600 billion over a decade. Now lawmakers may be forced to tackle broad-based reforms—or face the ire of millions of middle-class taxpayers.

That will eat a lot of cash, and looming over Bush's ambitious agenda is a huge budget deficit. He vows to cut the red ink to \$250 billion in five years. But the Iraq war, the AMT fix, recently enacted corporate tax cuts, and any bid to make tax cuts permanent may make that nearly impossible. "Bush's budget numbers just don't

EXULTANT Young voters may have helped Bush as much as they helped Kerry

add up," says William C. Dudley, chief economist at Goldman, Sachs & Co.

Bush will face a backlash next year from Democrats and even some Republicans worried about the deficit. Lawmakers such as Senator John McCain (R-Ariz.) are outraged by the growth of Big Government, and Bush aides worry that he risks an intraparty fissure if he doesn't rein in spending. Bush also badly needs to jump-start the stalled Doha Round of global trade liberalization, somehow finessing a North-South spat over farm subsidies. Holders of copyrights, such as the entertainment biz, software makers, and pharmaceutical giants have a huge stake in moving the talks off dead center. But corporate lobbyists worry that the trade round could become a casualty of Bush's obsession with the Iraqi endgame.

While his path is strewn with obstacles, not everything is out of reach. Lobbyists suspect that the threat of oil hovering around \$50 a barrel may finally produce action on the Administration's stalled energy bill. "If we start over and de-pork this thing, we could have a bill soon," says one corporate rep. In a similar vein, Bush's plan to extend the accountability provisions of the No Child Left Behind Act could be settled the old-fashioned way—by buying off Democrats with an injection of spending.

With money scarce, Dems digging in, and Iraq a powder keg, the next four years look perilous for the triumphant President. But few expect Bush to flinch. "With any other President, I'd expect caution," says Bruce Buchanan, a government professor at the University of Texas at Austin. "With Bush I don't think there's any question: He'll go for broke."

The question for Americans struggling to absorb the message of Election 2004 is this: Will a headlong bull rush—which served Bush splendidly in the tax fight and failed him in Iraq—produce an agenda that somehow melds the disparate dreams of a deeply divided nation? Or will his second term, like that of many Presidents before him, end in a heap of grand ambitions gone awry? ■

—By Lee Walczak, Howard Gleckman, and Rich Miller, with Richard S. Dunham and Paul Magnusson, in Washington, and bureau reports

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STATE RACES

IN CONGRESS, A VANISHING CENTER

This year's big change: Staunch conservatives scored strategic victories

IF YOU THINK YOU'VE SEEN BITTER partisan feuding in recent years on Capitol Hill, fasten your seat belts. Despite a white-knuckle Presidential race and a relatively narrow congressional majority, Republican leaders show little inclination to reach out to embittered Democrats. "There is no incentive for either side to compromise," says Amy Walter of *The*

Cook Political Report. "If Republicans can pass whatever they want, why talk to conservative Dems?"

Yes, there will be obligatory odes to bipartisanship. But the 2004 election has delivered Republicans to office who are even more conservative than their predecessors. That has Dems vowing to do everything they can to end a decade of GOP domination in the 2006 midterms.

The big change on Nov. 2: The armies of the Right won major Senate victories, the most symbolically important being the defeat of Democratic Minority Leader Tom Daschle of South Dakota. The winner in that race, former Representative John Thune, will join five of his former House colleagues in moving up to the Senate.

All of these Republican victors came to Washington in the mid-to-late 1990s as strong disciples of the Gingrich Revolution. The result: While the GOP's margins remain slim in both chambers, the political center in Congress has shifted to the right. Two of the new senators, Richard Burr of North Carolina and Jim DeMint of South Carolina, are replacing Democratic populists. The third, firebrand Tom Coburn of Oklahoma, compiled one of the most conservative voting records in Congress during three terms in the House of Representatives.

For both parties, the center will be a lonely place on Capitol Hill. On the House side, moderate Republicans Amo Houghton and Jack Quinn of New York

THE NEW CONGRESS

	HOUSE SEATS			SENATE SEATS		
	Old	New*	Gain/Loss	Old	New	Gain/Loss
DEMOCRATS	205	201	-4	48	44	-4
REPUBLICANS	229	231	+2	51	55	+4
INDEPENDENTS	1	1	0	1	1	0

*Two Louisiana seats, one Republican, one Democratic, are headed for a December run off



DAVID VITTER
(R-La.)
Senator-elect

LISA MURKOWSKI
(R-Alaska)
Senator reelected

could slow them down. They "want to carve out a separate identity," says John J. Pitney Jr., professor of government at Claremont McKenna College. "If the President's poll numbers go down, they won't get points for being his faithful servant."

Senate Democrats, meanwhile, will have to anoint a new commander. Whip Harry Reid (D-Nev.), who is more moderate than Daschle, will probably take on the leadership mantle. But that doesn't mean the Dems will suddenly adopt a more conciliatory posture. With the departure of centrist Democrats, the caucus is leaning ever more to the Left. In particular, liberal stalwarts like Senator Edward M. Kennedy (D-Mass.)

and Senator Patrick Leahy (D-Vt.), still angered by Vice-President Dick Cheney's obscenity-laced attack earlier in the year, are ready to unload on any Bush Supreme Court picks. These lions of the Left also "may not run for reelection," says Wendy J. Schiller, who teaches of political science at Brown University. "That

could further embolden them to lead the charge on judicial picks."

What's more, the Democrats' biggest new star, Barack Obama of Illinois, has unabashedly advocated a left-of-center platform. Obama, who will be the sole African American member of the Senate, electrified the Democratic Convention last summer with his keynote address, and party leaders hope he will become a high-profile critic of conservative excess. With his election all but assured, Obama campaigned for other Democratic candi-

dates, so he arrives in Washington with plenty of chits and a rock-star rep.

Democrats would like to think that Obama's victory heralds better days. But for now, Congress is in the hands of the Right. That gives President Bush a window of opportunity to push an ambitious agenda that could form the cornerstone of his legacy. ■

—By Alexandra Starr in Washington

opted against another run. And in the Senate, without retiring Democrats John Breaux of Louisiana and Bob Graham of Florida, there will be precious few Democratic moderates remaining. Centrist Republicans are hoping that incoming freshman Ken Salazar (D-Colo.) will help to fill the gap.

In the House, the polarization trend will be exacerbated by the gerrymandering of the Texas congressional map. House Majority Leader Tom DeLay (R-Tex.) was the major architect of the scheme, which cost four incumbents their seats, including Representative Charles Stenholm (D-Tex.), the last of the conservative Southern Boll Weevil Democrats. The Texas map will set an example of egregious redistricting that could encourage similar efforts in other states by both parties. That's because redistricting is helping to create "incumbents [who] are virtually invincible," according to *Cook's* Walter. "Many districts got safer."

GERRYMANDERING WOES

STILL, DEMOCRATIC strategists see a silver lining in the Texas debacle: It could take a toll on DeLay. Some of his associates in the redistricting scheme have been indicted by a Texas grand jury for alleged campaign-finance abuses, and their trials—and the continuing probe in Austin—could prove embarrassing to the Majority Leader, who earned back-to-back chastisements from the House ethics committee this fall. For

now, though, DeLay is in charge, and the House will probably take the lead in pushing through Bush-agenda items such as Social Security reform.

The Senate, however, could prove more problematic, even with the addition of several conservative members. Though the Republicans increased their



PETE SESSIONS (R-Tex.) Representative reelected in a redistricting juggernaut engineered by DeLay



MELISSA BEAN (D-Ill.) The Representative-elect was one of the few challengers to knock off an incumbent

margin of control by four seats, they fell well short of the 60 votes it takes to overcome a Democratic filibuster. In addition, several prominent GOP lawmakers in the upper chamber—including Senate Majority Leader Bill Frist (R-Tenn.) and National Republican Senatorial Committee Chairman George Allen (R-Va.)—are weighing 2008 Presidential runs of their own, and blind loyalty to Bush

COMMENTARY

BY PAULA DWYER

Crisis Averted—This Time

But voters still face confusion at the ballot box. And now there's no excuse

In 2000, when Florida's photo finish resulted in the U.S. Supreme Court awarding the state's Electoral College votes—and the Oval Office—to George W. Bush, Congress and state officials collectively vowed “never again.” But the passion to modernize the creaky election system faded fast. After the 2000 Florida follies, it took nearly two years for a closely divided Congress to

adopt the 2002 Help America Vote Act (HAVA), which imposes on the states some of the most ambitious election reforms in a century.

The delay meant that the law's centerpiece—an election assistance commission to set national voting standards and dole out funds for electronic voting machines and registries—was not in place in time for the 2004 contest. Congress appropriated only \$1.5 billion out of a possible \$4 billion authorized by the law this year.

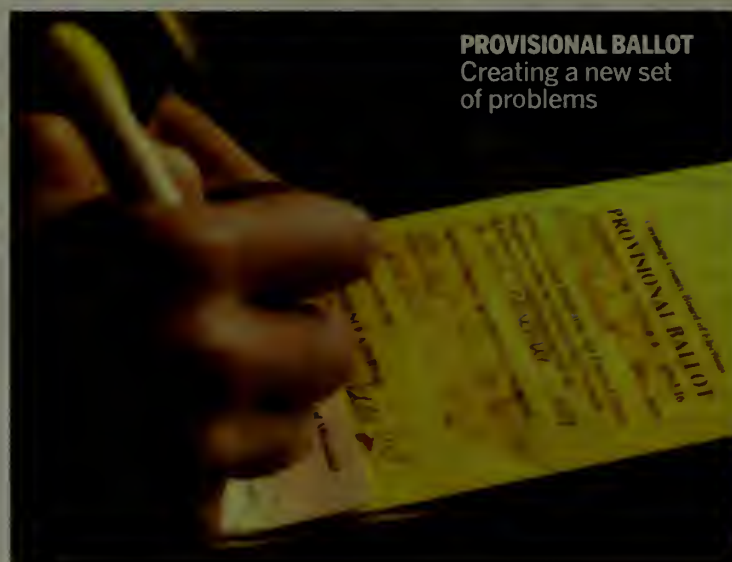
Moreover, the law's other achievement—mandatory provisional ballots for voters whose registration is in question—came without operating instructions from Washington. It was left to the states to decide which provisional ballots to count and which to toss. “Congress enacted a [statute] that didn't give enough guidance,” says Edward B. Foley, director of election law at Ohio State University's Moritz College of Law. “It could be called the Hinder America Vote Act.”

This time, the High Court didn't have to intervene, but that doesn't mean election chaos can't happen again. Given the estimated 120 million voters—the highest turnout since 1968—and the outbreak of pre-election lawsuits, voting experts agree that the country dodged a bullet. Bush's comfortable margin of victory in several battleground states, and a lot of luck, kept in check legal battles over registration, balloting, and vote-counting procedures. But Congress and the states still have much

work to do to make sure that every vote counts. “There has to be a massive movement, and it has to be at the grassroots level, to force federal, state, and local officials to find a solution,” says Ralph G. Neas, president of People for the American Way, a civil-rights group. “It's going to cost billions of dollars just for the machinery and [to] make sure the training gets done.”

Congress could pick up where it left off by cleaning up the provisional ballot mess. HAVA requires states to give such ballots to people who believe they are registered and show up to vote only to discover that their names aren't on the local registry. Of all the issues litigated before Nov. 2, which provisional ballots should be counted was the most divisive. Ohio's 160,000 or so provisional ballots kept the Buckeye State's results up in the air until Democrat John Kerry conceded on Nov. 3.

Why the confusion? When Congress passed HAVA, it failed to say which of those ballots should be counted, resulting in different standards in different states. The lack of guidance was exaggerated by massive voter-registration drives by both parties and allies such as so-called 527 committees. In many cases, low-paid workers or volunteers would help potential voters fill out registration forms. But unless those who signed up took the unusual step of calling the registrar's office to make sure their forms were actually filed, new voters didn't know until Nov. 2 if they were



PROVISIONAL BALLOT
Creating a new set
of problems

properly registered. Some states decreed that provisional votes cast in the right county would count; others accepted provisional ballots only if cast at the smaller precinct level. “By creating provisional ballots, HAVA has created more problems” than it solved, says Suzanne Haik Terrell, a former Louisiana elections commissioner. Provisional ballots also raise a fairness question: Why should a vote count under one state's rules but not under another's?

While Congress is issuing uniform rules on provisional ballots, it should also allocate more funds for states to build the electronic voter databases that HAVA mandates. Only 15 states have them today. The absence of such statewide rolls, says Doug Chapin, director of electionline.org, a nonpartisan voting reform group in Washington, is the biggest cause of vote-count breakdowns. Unless electronic databases become the norm,



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voter rolls will remain hit-and-miss, especially in years like 2004, when some 10 million new voters registered. "The underlying root cause of Election Day chaos is a lack of money and guidance from the federal government," says Chapin. "It's not a failure of will."

Another problem Congress must address: vote-counting deadlines. While HAVA now says that states must standardize counting procedures, a dizzying patchwork of absentee, overseas, and provisional ballot deadlines among the states magnified election confusion. Pennsylvania, for example, insisted that overseas ballots must be in by Oct. 29 until it was forced to extend that deadline under threat of litigation. Iowa requires

overseas ballots to be postmarked by Nov. 1 and received by noon on Nov. 8. Florida counties have 10 days, until Nov. 12, to count both overseas and provisional ballots, while many states don't start counting until Nov. 12. Confused? So is the rest of the country.

**Even
"state-of-the-art"
machines
are
suspect**

And while voting machinery problems are decreasing as states update their technology, they didn't disappear altogether on Nov. 2. Indeed, some of the newer touch-screen machines came with their own controversy: the lack of a paper record to verify voter choices and audit results. Election-reform groups are even alleging that it's possible to program malicious code to distort the count. Such suspicions convinced precincts in Ohio, California, and other states to stick with low-tech equipment. On Nov. 2, some 30 million voters in 32 states used punch-card machines. "It's incomprehensible to me that the worst problem of the [2000] election hasn't been dealt with yet," says David Boies, who led Al Gore's unsuccessful legal team in 2000. Congress should make sure that all voters are using state-of-the-art machines by 2006 and that funds are available to pay for them.

None of this will be easy and it certainly won't be cheap. But it will be necessary to maintain voters' faith in the system. It would be a shame if the positive gains from this year's election—high turnout and an intense level of interest in the candidates and their positions—is frittered away because of another bout of election dysfunction. ■

—With Lorraine Woellert in Washington

LEGAL AFFAIRS

Tort Reform: Is the Road Clear At Last?

Business groups waging war against the powerful trial lawyers' lobby found little satisfaction during President Bush's first term. Distracted by the war on terror and Iraq, Bush put tort reform on the back burner. But with his Nov. 2 victory, Corporate America has reason to believe that Bush II will make the issue a priority. On the campaign trail, tort reform was a frequent—and surefire—crowd-pleaser; Bush routinely insisted that frivolous lawsuits were hiking the cost of health care and killing jobs.

Now Corporate America is gearing up to win three big prizes: caps on medical malpractice damages, which business believes will lower health-care costs; a move to make class actions less expensive to defend; and a business-funded global settlement to compensate workers and others harmed by asbestos. "With the renewed focus of the Bush Administration, we could have a lot of success," says Sherman Joyce, president of American Tort Reform Assn.

Reformers are so optimistic that they hope to wrap up a measure on class actions before Inauguration Day. The legislation, long stalled in the Senate, would move many multi-state class actions to federal courts, making them easier for business to defend. Supporters had enough Democratic votes to break a filibuster earlier this year, but business—and the GOP leadership—dropped the ball. Now they think they can tack the measure on to an omnibus spending bill during November's lame-duck session of Congress.

That would be just the beginning. Proponents of caps on medical malpractice awards think they can roll

language into any broader health-care legislation the next Congress tackles. Even the Clinton Administration's Health & Human Services Dept. found that anything that reduced doctors' and hospitals' liability—such as caps—could save the health-care system \$60 billion to \$108 billion a year, simply by reducing the practice of defensive medicine. Advocates say caps also would lead to fewer lawsuits, making physicians' malpractice insurance more affordable and reversing a trend that's seeing doctors shutting their practices. With a half-decent push from the White House, lobbyists believe

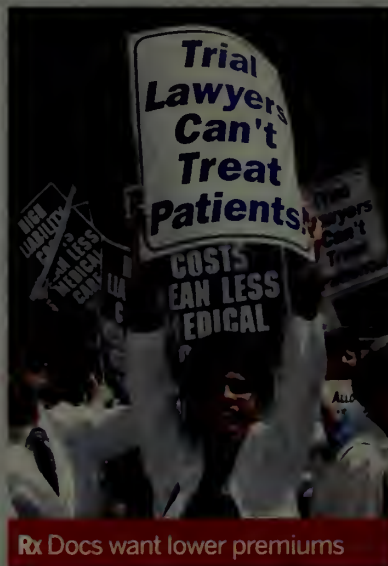
malpractice reforms could actually happen next year.

An asbestos breakthrough will be tougher. For two years labor, management, and the trial bar have been negotiating to set up a fund to compensate victims whose diseases are linked to asbestos exposure. But as talks drag on, and labor and lawyers make more demands, the fund keeps growing—hitting \$145 billion at last count. Businesses,

particularly insurers, want to give up on the pool in favor of a less ambitious plan requiring asbestos claimants to be truly sick before a court hears their cases. A smaller trust would compensate victims suffering from the worst kind of asbestos cancer. But the biggest hurdle to a deal isn't Congress—it's the deep divisions within business itself.

Tort reform isn't a done deal. The Dems may be in no mood to play ball. Trial lawyers remain a potent lobby. And some Republicans remain ambivalent, including Senator Arlen Specter (R-Pa.), the likely chair of the Judiciary Committee next year. Still, with billions of dollars at stake, business is likely to find ways to get it done.

—By Lorraine Woellert in Washington





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FOREIGN POLICY

A TIME FOR REALISM AND REACHING OUT

Bush & Co. have an opportunity to pause, take stock of mistakes, and adjust course

JUDGING FROM PRESIDENT Bush's campaign rhetoric over the past several months, you might think the occupation of Iraq has been a smashing success. He talked of "freedom on the march" and, when asked if any mistakes had marred his first term, couldn't cite one beyond personnel choices. Vice-President Dick Cheney, too, made a point at every campaign stop of extolling the Administration's record in Iraq, recently calling it a "remarkable success story."

But the reality on the ground told a different tale: one of daily car bombings, massacres of Iraqi police, executions of innocent hostages by terrorist groups, and a situation made worse, in part, by

American errors and misjudgments in the immediate aftermath of the invasion and during the months that followed. Now, with the election over, the Bush Administration will have to put aside the rosy rhetoric of the campaign and deal with those hard realities.

More than that, the Administration must face other daunting foreign policy challenges. Nuclear proliferation in Iran and North Korea loom large. The Arab-Israeli conflict needs careful ministering. And Bush must mend fences with deeply suspicious allies. In sum, the foreign policy team will start the Bush Administration's second term with its work cut out for it. But that also means an opportunity to pause, take stock of its mistakes, and adjust. Many hard lessons have been

learned as the conflict has deepened over the past 18 months. Here's a look at what they could mean for U.S. foreign policy:

RETHINK IRAQ Sunny campaign rhetoric aside, the mess in that nation has already forced the Bush team to moderate its grand vision of spreading democracy and modern markets to the broader Islamic world. Both the earlier idealism of Deputy Defense Secretary Paul D. Wolfowitz and the blustery can-do pragmatism of Vice-President Dick Cheney and Defense Secretary Donald H. Rumsfeld have been humbled. From now on success will be measured simply by managing to bring some level of stability to Iraq. Says the Brookings Institution's Michael E. O'Hanlon, who tracks Iraqi reconstruction: "I think the Administration has become a lot more realistic recently."

Indeed, Washington is increasingly moving toward far more modest goals than it once held. Rather than setting the stage for democracy and free-market capitalism to flourish, it is currently focused on clearing out insurgents in Fallujah and other Sunni rebel strongholds. That in itself will be no easy task, but it would at least enable the country to hold an election—if not by January, then sometime in 2005. Afterward, the Administration hopes to ensure that a sufficient number of Iraqi security personnel receive the training they need to keep a lid on the insurgency. With that much in

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place, the troops could start coming home, perhaps starting by 2006.

REVIVE THE POWELL DOCTRINE Put another way, it is time to shelve the discredited Rumsfeld Doctrine. Rumsfeld's vision of shrinking the number of troops involved in the invasion and moving toward lighter, more mobile brigades has turned out to be deeply flawed: The lightning-swift toppling of the Hussein regime quickly gave way to military backsliding and social chaos as too few U.S. troops were on hand in the aftermath of the war to secure the country. Now the Administration is reversing course. Washington plans to expand the overall size of the U.S. Army and is holding on to more heavy tanks and is buying the heavily armored vehicles that are proving to be critical to saving soldiers' lives.

RELAUNCH MIDDLE EAST PEACE TALKS

Right or wrong, many Islamic countries and their citizens link the Iraq war to what they perceive as America's anti-Muslim policies and one-sided support for Israel. As Israel prepares to withdraw from Gaza, experts say it is critical that the U.S. refocus its diplomatic energies on brokering talks between Israel and the Palestinians. And with PLO Chairman Yassir Arafat ailing, boosting the risk of violence as various factions vie for influence in a power vacuum, Washington has a unique chance to try to build backing for moderates and energize talks.

For starters, the U.S. could begin to engage again by working with Israel and the Palestinians on security arrangements for Israel's pullout. If Bush fails to seize the opportunity, a bloody denouement in Gaza seems inevitable: Palestinian hard-liners are expected to intensify anti-Israeli attacks to make it seem as if Israeli Prime Minister Ariel Sharon is retreating. That could prompt the Israeli leader to hit back in what could become a spasm of violence. "He is going to get out of Gaza," says Dennis Ross, a former Middle East peace negotiator now at the Washington Institute for Near East Policy. "But he isn't going to let Israel be humiliated."

REACH OUT TO ALLIES Sure, the U.S. is a mighty superpower, but that power has its limits. The Bush team has proven its natural distaste for working closely with international organizations and allies that may disagree with its policies. But Iraq demonstrates that not even wealthy Washington can go it alone.

That's why Bush Team, Part II is likely to sound out Western European allies on decisions in Iraq and elsewhere. The U.N. will also play a role. As difficulties in Iraq mounted, the Bush Administration had little choice but to turn to it: Grand Ayatollah Ali al-Sistani, Iraq's most powerful



LESSONS LEARNED?

What Bush should take away from his first term

» Iraq requires realism. Forget building democracy in the Arab world. Stability would be enough.

» Overwhelming force is good. Trying to make the military light and mobile has its drawbacks in peacekeeping. Don't shrink the army or junk heavy tanks.

» Aid from abroad is good, too. Even a hyperpower needs help. Don't needlessly anger allies or the U.N.

» The Middle East can't be ignored. Relaunching the peace process will not just improve America's image in the Islamic world—it could also stop the Israeli-Palestinian conflict from spinning out of control.

» U.S. leadership matters. Bush's hands-off approach on Iran and North Korea may be fostering nuclear regimes. Washington needs to engage in real diplomacy rather than leaving those talks to allies.

cleric, wouldn't cooperate with election plans until the U.N. entered the picture. Beyond Iraq, the war on terror will require global cooperation on intelligence, financial tracking, and law enforcement.

REENGAGE AROUND THE GLOBE Given the threat of nuclear proliferation, the

narrow focus on Iraq has cost the U.S. dearly. Taking a backseat to China, South Korea, and Japan in the Six Party talks over North Korea's nuclear program enabled Pyongyang to reprocess spent fuel rods and possibly make several bombs. Moreover, three European countries have

ARAFAT New Palestinian leadership could help Bush reenergize peace talks

begun discussions with Iran about its nuclear program. In the process, Tehran has forged ahead with the development of nuclear

capabilities. In neither case has the U.S. taken the lead in putting forth a serious, detailed proposal that could be the basis for negotiation.

Washington says it wants a diplomatic resolution, gripes an Administration insider, but refuses to negotiate. Will that change in a second Bush term? The answer is unclear. The White House has promised to take Tehran to the U.N. Security Council for possible sanctions. To succeed in that effort would take intense diplomatic efforts.

The problem for the Bush Administration, though, is that diplomacy on nuclear proliferation may be too late in the case of Iran. That country, like Pakistan and India before it, may never be persuaded to give up its nuclear program. "Iran, I think, is a tougher nut than North Korea," says Deputy Secretary of State Richard L. Armitage.

Can the next Bush team make these crucial foreign policy corrections? That's a tough call. Many within the Administration are resisting change, to say nothing of the fact that Bush and Cheney themselves are the ultimate hard-liners. Yet a big overhaul for the foreign policy team may be on the way. If Rumsfeld leaves, that could help bring change.

A second term is not about reelection but about the history books. His first four years have given George Bush plenty to ponder. Whether he can adapt policy to the realities of Iraq, Iran, North Korea, and the Middle East is the issue. One way or the other, Bush will leave behind a legacy. His ability to learn from the past will determine how posterity will treat it. ■

—By Stan Crock, with Lee Walczak, in Washington; Laura Cohn in London; Carol Matlack in Paris; and Jack Ewing in Frankfurt



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COMMENTARY

BY RICHARD S. DUNHAM

The World Has Changed. Why Can't the Dems?

Another election, another lost opportunity to craft a lasting vision

DEMOCRATIC OPERATIVES are quick to dismiss John Kerry's defeat as the byproduct of political circumstance: a flawed, flip-flopping candidate and a misfiring campaign that couldn't persuade voters to replace the Commander-in-Chief in the middle of the war on terror. But such excuses, while partly valid, miss the bigger point: Democrats keep losing Presidential elections they could have won.

Yes, the aloof, aristocratic Kerry wasn't anyone's idea of a dream candidate. But there were also fatal weaknesses in Al Gore's 2000 bid. And what about Michael Dukakis? And Walter Mondale? They were all judged far too liberal to be entrusted with the White House.

George W. Bush's 2004 victory highlights problems with a Presidential nominating process that regularly leads Democrats to select out-of-the-cultural-mainstream candidates. For the better part of three decades, Dems have struggled to remain competitive in elections where most voters thought they were out of step on security and values. Without neutralizing those concerns, Democrats have little chance of once again becoming the majority party they were from the New Deal through the Great Society. "Something went wrong [in 2004] besides a lousy candidate," says John Kenneth White, a political scientist at Catholic University. "Democrats need to say: 'We ought to look to see if we have a party problem here.'"

The narrowness of Kerry's Electoral College defeat may keep many of the party faithful from realizing how deep that problem really is. To lose an election when the party base was charged up—and turned out in massive numbers—means that there simply aren't enough loyal Democrats to carry a Presidential candidate to victory. Indeed, the last Democrat to reach 50% of the vote was Lyndon B. Johnson in 1964.

In the intervening decades, the party's socially liberal standard-bearers have watched a steady erosion of support from voters who once made up the heart of the New Deal coalition:



ROVE He mobilized a base eager to protect the country from liberals

blue-collar, less educated, and rural whites. What's left is a bicoastal party that has an ever-more-difficult time competing in the industrial heartland and has collapsed in the South—once the twin peaks of its power. Continuing to wallow in nostalgia and trying to reassemble the New Deal coalition relegates Democrats to long-term minority status. "If there's a silver lining [in Kerry's defeat], it is that it's going to eliminate the ability [of Democrats] to argue that we have a natural majority on our side," says California venture capitalist Andrew S. Rappaport, a

leading funder of Democratic causes. "We don't. It's over."

Changing the nomination process to reduce the power of interest groups might be a start. Although polls show that Democratic liberals are outnumbered by party moderates and conservatives, they dominate the primaries. In 2004 former Vermont Governor Howard Dean's unexpected surge as the candidate of the hard-core antiwar Left masked the fact that Dean's rivals were liberals, too—just of a more pragmatic stripe. Even retired General Wesley K. Clark, medals and all, ran as a down-the-line liberal. The only moderate in the nine-candidate field, Senator Joe Lieberman, failed to win a single primary.

Big Ideas

THEN THERE'S THE PARTY'S inability to come up with a lasting post-New Deal ideology. Bill Clinton's New Democrat formulation succeeded for eight years, but the past two nominees have diluted upbeat Clintonism with downbeat rhetoric, harping on tax cuts for the rich and scaring the elderly with warnings about Social Security privatization.

Both Gore and Kerry allowed Bush strategist Karl Rove to frame the 2000 and 2004 elections as contests between a future-oriented Republican who backed reforms of pensions and health care and a retro-liberal who promised to restore the Rust Belt, slow outsourcing, and put the engine of Big Government



BOSTON HEARTBREAK
Will the narrow
defeat blind Dems
to party problems?

to work for the working class. Republicans once were the moss-backed defenders of the way things used to be. Nowadays it's the Democrats who pine for yesteryear and their foes who style themselves as New Economy visionaries.

Until Dems come up with a compelling call to modernity, they'll have trouble snagging enough suburban swing voters and urban investors to build an Electoral College majority. "The way for us to put together a winning coalition is to talk about big ideas, like Clinton did," says Al From, CEO of the centrist Democratic Leadership Council. "When we break up into constituency groups and try to piece together a coalition, it never works."

The biggest reason that the coalition won't jell: Democrats must come to grips with the reality that they are increasingly on the losing side of America's cultural divide. In this election, millions of blue-collar economic populists rejected a Massachusetts liberal because they felt he did not share their values on issues ranging from abortion to affirmative action, from guns to gay rights. More than two-thirds of churchgoing Christians—including millions who disapproved of the President's handling of the economy and the war in Iraq—nevertheless voted for Bush. The cultural chasm cost Kerry dearly in states he badly needed to win, such as Missouri, Iowa, and West Virginia.

Complicating Democratic comeback efforts is the specter of terrorism. For two elections—in 2002 and 2004—Republicans have successfully used security fears to beat the opposition. The Democratic weak-on-terrorism label is a throwback to the Vietnam era and its aftermath, when the party was tagged as soft on defense.

With the fall of the Berlin Wall and the Soviet

empire, Democrats thought they had escaped the old stereotype. But Bush effectively painted Kerry as an antidefense, anti-intelligence liberal trapped in a September 10 mindset. The attacks on Kerry's Navy service and subsequent Vietnam protests by some Swift Boat veterans hurt him badly with blue-collar voters and military families. Despite Kerry's vow to fight "a smarter war on terror," Dems lost substantial ground among older men who remember the nuclear anxieties of the Cold War—and also among anxious moms who fear attacks. "Voters have traditionally seen the Republican Party as strong on defense and strong on the projection of military force," says Republican pollster Tony Fabrizio. "It's going to take the Democrats time to neutralize that."

Whether the Democrats return to Clinton-style left-right fusion and embrace post-September 11 hawkishness in 2008 depends largely on the party's nominee. The two early favorites are Washington insiders with close ties to liberal constituency groups: New York Senator Hillary Clinton and defeated Vice-Presidential candidate John Edwards. But if history is any guide, the party's path to victory could run through statehouses, where innovative governors such as New Mexico's Bill Richardson, Virginia's Mark Warner, and Iowa's Tom Vilsack are known to nurture White House ambitions.

Indeed, the past two Democratic Presidents have been governors—Southern governors, to be precise—who bridged the nation's cultural divide. It'll take similar skills for another Democrat to win. But without serious soul-searching about the changing electorate and unchanging verities of the primary process, the Dems are likely to play this tune again and again. ■

**Millions of
blue-collar
felt Kerry
didn't share
their core
values**

EDITED BY MONICA GAGNIER

HEADLINER TOM FRESTON



MOGUL-IN-TRAINING

It could be Tom Freston's own Mission: Impossible. The 58-year-old **Viacom** co-president must overhaul **Paramount Pictures** to win the horse race against fellow Co-President and CBS Chief Leslie Moonves, 56, to succeed Viacom Chairman Sumner Redstone, 82, who says he's leaving in three years. Freston has a chance, thanks to the Nov. 2 announcement by Sherry Lansing, 60, that she will be retiring as Paramount chairman. A Hollywood icon, Lansing lately has been churning out flops such as *The Stepford Wives*.

Freston, who built Viacom's MTV unit into a cable powerhouse, intends to loosen the purse strings at tightfisted Paramount to produce the hits needed to boost the bottom line. Among the candidates that he's looking at to replace Lansing are Universal studio chief Stacey Snider, producer Brian Grazer, and former Fox studio chief Bill Mechanic. Whoever takes the assignment will need a little of Tom Cruise's derring-do to turn around Hollywood's weakest performer.

—By Ronald Grover

TIME WARNER DOLLAR DAZE

Time Warner said on Nov. 3 that it's setting aside \$500 million related to federal investigations into its accounting. The media giant also will restate earnings for 2000, 2001, and possibly 2002, because it should have consolidated the **AOL Europe** division in financial statements during that period. In 2000, **Goldman Sachs** acquired 1% of AOL Europe, AOL's partnership with Germany's **Bertelsmann**, to keep AOL's stake below 50% (BW—June 28). As a result, AOL believed it didn't need to consolidate AOL Europe on its books. The **Securities & Exchange Commission** will probably rule otherwise and is starting to look into whether Goldman "aided and abetted" AOL in violation of securities laws, says a source. Time Warner officials declined to comment beyond the restatement announcement. A Goldman spokesman said the firm had no comment. (For more, go to www.businessweek.com.)

STEM CELLS' GOLDEN STATE



California money managers are among those celebrating the passage of the state's controversial Proposition 71, which approved \$3 billion in long-term bonds to fund

stem-cell research. Prop 71, which won 59% of the vote, had been challenged by fiscal conservatives and by those who oppose using human embryos in research. Still, the proposition got the support of Governor Arnold Schwarzenegger, who says it will boost California's biotech industry. Under the initiative, a new medical institute will award up to \$350 million a year in grants and loans to research facilities in the state.

ENRON: THE FEDS WIN ONE

Many people have attacked the **U.S. Justice Dept.**'s Enron Task Force for taking so long to haul the company's managers into court, but nobody can argue with the results. On Nov. 3 government prosecutors won convictions against four former **Merrill Lynch** executives and one midlevel Enron manager for their role in the energy giant's financial meltdown. One ex-Enron employee was acquitted. The victory in the so-called Nigerian barge trial bodes well for the feds as they prepare for the ultimate showdown: the criminal trial against former Chairman Kenneth Lay and ex-CEO Jeffrey Skilling, which now appears as if it will take place next year.

CIGNA: WHAT A QUARTER

Cost-cutting programs and asset sales helped **Cigna's** third-quarter earnings rise 64% while revenue from continuing operations slipped 6%. A \$79 million gain on the sale of a retirement-benefits unit helped, but CEO Edward Hanway credited progress in "medical management, service, and underwriting"

for a 77.6% rise in health-care segment earnings. As competitors such as **UnitedHealth Group** have poached on its corporate coverage, Cigna has responded with programs that help employers cut their medical bills.

ET CETERA...

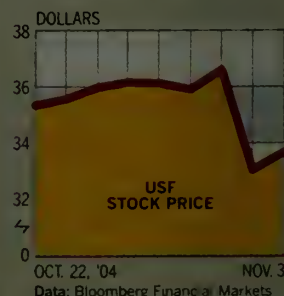
» **Yahoo!** hired ex-ABC **Entertainment Television Group** Chairman Lloyd Braun to run its entertainment biz.

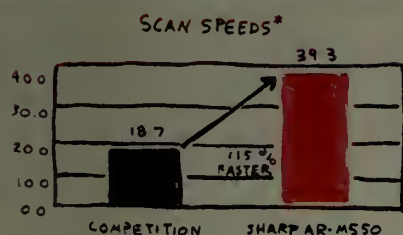
» The **SEC** extended an order exempting banks from broker-dealer registration until Mar. 31, 2005.

» **Oracle** raised its hostile cash bid for rival software maker **PeopleSoft** by 14%.

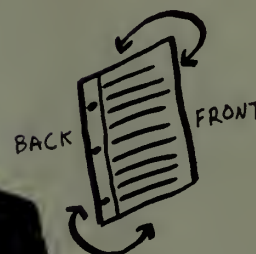
CLOSING BELL

On Nov. 2, two weeks after **USF** reported weak earnings, CEO Richard DiStasio quit the trucking outfit. His unexpected resignation sent **USF** shares skidding 10%, to \$32.99, though they rebounded slightly on Nov. 3 to close at \$33.70.





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A CHINESE FIELD
Oil demand will
double by 2020



CHINA

THE GREAT OIL HUNT

China needs energy more than ever. Its quest for oil and gas to keep its economy humming will change the world

FOR A SENSE OF JUST HOW vast China's energy needs are, take in the night views from the observation deck of Shanghai's Oriental Pearl Tower. From that perch, you'll see a spaghetti jumble of bright neon illuminating the colonial-era buildings of the waterfront Bund, while the shiny skyscrapers of Pudong twinkle into the night. Across the city, long lines of trucks, buses, and cars clog narrow

lanes and new expressways. Oil tankers in the harbor unload yet more fuel to keep the city of 20 million humming, while just out of sight lies Shanghai Baosteel, belching smoke from the tons of coal its forges consume daily.

As China's economy expands, so does its thirst for oil, gas, coal, and electricity. Today, China accounts for 12.1% of the world's energy consumption. That's second only to the U.S., at 24%, and up from 9% a decade ago. By 2020 the country's

demand for oil will nearly double, to 11 million barrels a day, and natural gas consumption will more than triple, to 3.6 trillion cubic feet annually, according to a U.S. Energy Dept. forecast. That means China will play a key role in influencing global oil prices and energy investment flows—not to mention climate-destabilizing carbon dioxide emissions. "There is going to be a huge increase in consumption across the region, and especially in China," says Edu Hassing, an energy an-

analyst at the Asian Development Bank.

With China consuming ever more oil, it risks developing an ever-greater dependency on foreign crude. For the security-obsessed Chinese, that's scary. Right now, though, it's hard to see how the Chinese can avoid an uncomfortable dependence on Mideast oil. A decade ago, China was a net exporter of oil, but now it imports 40% of its crude as output declines at big northeastern fields. What about developing new sources at home? China is sitting on potentially rich reserves in the high deserts of the far west, but gas and oil there lie much deeper than in the northeast and will cost far more to get out of the ground.

COLOSSAL WASTE

MEANWHILE, China's power supply and grid haven't kept pace with demand. While power shortages have been common during recent summers, for the first time ever nine provinces in China are expecting outages this winter. "Energy could be an Achilles' heel of the government," says Scott Roberts, director of the China operations of Cambridge Energy Research Associates. Adding to the burden is colossal energy waste, thanks to primitive coal-mining techniques, loose building codes, and inefficient factories.

The Chinese know they have a problem, and last November the all-powerful State Council issued a "leapfrog strategy in the energy field" through 2020. The aims include securing more supplies abroad, shifting away from coal, building more hydro generators, upgrading the electricity grid, and pushing for more solar and wind power resources. The plan even calls for nearly 30 new nuclear reactors by 2020, in addition to the current nine. This year, China is expected to accept bids for building four 1,000-megawatt pressurized water reactors and is also handing out fat contracts for conventional power-plants,

cleaner coal-burning technologies, and wind power. "Growth is happening in all fuel types," says John Rice, chief executive of GE Energy, which last year nailed about \$900 million in contracts to build turbines in China.

Clearly, China is obsessed with securing—and safeguarding—sufficient oil supplies from abroad to keep its supergrowth on track. Coal is too polluting to rely on exclusively, and even nuclear energy won't come to the rescue. The new reactors, when up and running, will kick in only about 4% of the juice the country needs. Oil, meanwhile, fuels China's vehicles and keeps many of its factories churning out goods. Although crude has fallen some from its recent \$55-a-barrel high, experts expect Chinese demand

Japan and China are clashing over control of a natural gas field

will help prop up prices for years to come. And Beijing knows how vulnerable China might be if it grows too dependant on imported oil. In fact, the military has published a book, called *Liberating Taiwan*, that imagines Chinese warships seizing sea routes to the Persian Gulf and imposing an oil embargo on Taipei, Tokyo, and Washington.

Beijing wants no such energy cutoff for the mainland. So the Chinese are grabbing what they can—and fending off anyone with a rival claim in a show of muscular petrodplomacy. Look at the Chunxiao gas field, which China says lies in its waters in the East China Sea. Japan says part of the field lies in its waters, so Tokyo wants its share. Too bad: A Chinese group has started drilling there. The

China's Energy Terrain



China's consumption is second only to the U.S., but reserves are modest. So it's scrambling for new sources

OIL	NATURAL GAS	COAL	NUCLEAR	HYDRO-ELECTRICITY
Proven Reserves 23.7 BILLION METRIC TONS	Proven Reserves 5.23 TRILLION CUBIC METERS	Proven Reserves 114 BILLION METRIC TONS	Annual output equivalent of 9.8 MILLION METRIC TONS OF OIL	Annual output equivalent of 6.4 MILLION METRIC TONS OF OIL
Share of world total 2.1%	Share of world total 1%	Share of world total 11.6%	Share of world total 1.6%	Share of world total 10.8%

two tried to smooth things over in meetings on Oct. 26, but they got nowhere. "I don't know why these talks were even held," fumed Japan's Economic Trade & Industry Minister, Shoichi Nakagawa.

Japan and China are also clashing over the route of a pipeline across the dark forests and frozen steppes of Siberia. Tokyo wants Russia to build a pipeline to the Pacific port of Nakhodka, where the oil could be transferred to tankers and shipped to Japan and other markets. Beijing is seeking a shorter route that would terminate in the northeastern city of Daqing. China has bent over backward to outfox Japan, and in October even settled a long-standing border dispute with Moscow. But it's almost certain that Japan will triumph, because the Chinese plan would give Russia no flexibility in selling its oil to other customers. "It's like being tied to someone during a knife-fight," says Ronald Smith, an analyst at Renaissance Capital in Moscow.

IFFY RESERVES

WITH THE RUSSIAN pipeline far from a sure thing, Chinese companies have signed oil or natural gas exploration deals in Australia, Iran, Kazakhstan, Sudan, and elsewhere. So far, these deals represent just 10% of China's oil imports. Even so, Beijing says they're important. "China has to look at supply security," says Mark Qiu, chief financial officer of exploration company CNOOC Ltd., "and the name of the game in energy security is diversification."

Can Western companies profit from China's oil obsession? Beijing has pushed for listings of its big oil companies on international markets to cement tie-ins with overseas energy producers, and BP, ExxonMobil, and Royal Dutch/Shell have all bought pieces of Chinese oil companies. Initially, the deals looked like a win for both sides. Chinese players would get foreign capital and exploration knowhow, while the Western petromajors would get a foothold in the world's fastest-growing energy market. It hasn't worked out that way. This year, Western companies have pulled out of two big projects: the Chunxiao gas development and a \$6 billion gas pipeline from the Western province of Xinjiang to Shanghai. Part of the problem is that Beijing has been slow in handing out domestic contracts to foreign players, so there's little incentive for the Western oil majors to foot big upfront investments.

To its credit, China is allowing foreigners into the crucial field of controlling pollution. Coal continues to be the source of

INDIA

A Thirst Brings a Thaw



GUJARAT FIELD Can India keep its oil flowing?

On the sidelines at the U.N. General Assembly meetings in New York last September, Indian Prime Minister Manmohan Singh and Pakistani President Pervez Musharraf held an historic meeting in which they agreed to seriously negotiate on economic cooperation. One tangible expression of that cooperation would be a 1,700-mile natural-gas pipeline from southern Iran to Rajasthan in central India, with Pakistan allowing the pipe to pass through its territory in exchange for a yearly transit fee of as much as \$330 million, plus some of the gas for its own use.

Funny how a thirst for energy can make the oldest of foes suddenly eager to cooperate. As India's economy undergoes a dramatic expansion, it finds itself desperate for new supplies of oil and gas. And diplomacy—even with fierce rival Pakistan—is one way of getting them. Indeed, India is conducting petroleum diplomacy throughout the region and beyond. Earlier this year, Indian oil major

Oil & Natural Gas Corp. (ONGC) signed an exploration deal with Burma. And India is negotiating with Bangladesh to buy some of its gas in exchange for electric power.

According to India's Planning Commission, the country needs to triple its power generation over the next two decades to feed its fast-growing technology and

manufacturing industries. But India is even shorter on energy resources than is neighboring China. It imports 73% of its oil now and projects that by 2030 that figure will rise to 90%. So ONGC has been scouring the world for new sources. Through subsidiary ONGC Videsh Ltd., over the past four years it has spent an estimated \$11 billion investing in 14 oil and natural gas projects in Sudan, Russia, Vietnam, Iran, Iraq, and Burma. And the government is learning how to use its diplomatic clout. While bidding for a 20%, \$1.7 billion share in Sakhalin I, a Russian offshore oil and gas field, in 2001, New Delhi exploited its 50-year-old alliance with Russia to win the deal.

Skeptics doubt that the energy linkups will do more than paper over long-standing enmities. Still, it's clear the Indian government isn't willing to let a shortage of energy curb the country's rise as an economic power. So whatever geopolitical obstacles may get in the way, the diplomacy of energy will continue.

—By Manjeet Kripalani in Bombay

70% of the nation's energy, but China is years behind in adopting cleaner coal-burning technologies such as scrubbers that trap pollutants before they can escape into the air. Last year, the Asian Development Bank found that just 5% of China's power plants had serious pollution controls. So China is letting foreign companies that specialize in cleaner-burning techniques, such as turning coal into gas or liquid fuel, start the cleanup. And the Chinese have begun experimenting with an emissions-trading market similar to those in the U.S. and Europe.

China also surprised critics in July by mandating some of the toughest auto-emission standards going.

That's encouraging, but it's only one part of the puzzle. It will take a sustained campaign of conservation, improved energy technologies, billions in investment, and loads of exploration luck at home and abroad for China to be truly energy secure. For the sake of its future prosperity, China needs to start getting a lot of things right—and quickly. ■■

—By Brian Bremner in Hong Kong and Dexter Roberts in Beijing



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ZHOU Will the central bank governor's interest-rate hike stem the flow of deposits?

returns on their cash. It's all technically illegal. But it goes on anyway, with lenders getting 8% to 20% on their money.

A 20% return beats a savings account any day. CSFB's Dong estimates that in August and September some \$17 billion worth of savings—1.2% of gross domestic product—fled the banking system to be invested elsewhere. If this gusher isn't capped soon, the established banks have a huge problem. The PBOC's Zhou is in the midst of a restructuring of the banks, cleaning up rotten loan portfolios, taking big write-offs, and teaching banks the basics of risk management with the goal of taking the strongest institutions public. While reforms are under way, the banks need their capital base to be strong.

UNTHINKABLE DEFAULT

SO WHAT CAN THE PBOC do? Analysts think its strategy is to move deposit rates up gradually, by perhaps 200 basis points over the next 12 months, to give depositors a real return. (Officials expect inflation to decline to about 3% over that period.) At the same time, the PBOC is removing the ceiling on lending rates and encouraging banks to start lending to private companies—something they rarely do now, since the government steers 70% of loans to state-controlled companies. If the state banks offer real competition to the informal lending sector, the gray market could start to shrink. That in turn would limit the opportunities Chinese depositors have to pull out of the banks and invest elsewhere. In reality, however, it will be hard for the PBOC to uproot the lending network, which is vast and well-developed, anytime soon.

One reason for that is the gray market's relative soundness. Lenders and borrowers usually know each other, resulting in what analysts say is a surprisingly low default rate. Often family members put up collateral, which makes default unthinkable. "The relatives who put up the money would lose face," says CSFB's Dong.

Can Beijing curb the runaway growth in such transactions? The PBOC is taking the right steps. But until the government creates a real banking system, the informal market will beckon many a borrower and lender. ■

—By Frederik Balfour in Hong Kong, with Dexter Roberts in Beijing

CHINA

THE LEAK IN CHINA'S BANKING SYSTEM

Chinese are taking their money out of state banks and lending it out themselves

THE PEOPLE'S BANK OF China's surprise decision on Oct. 28 to raise interest rates for the first time in nine years has spurred a furious reading of the tea leaves. One camp thinks the move by PBOC Governor Zhou Xiaochuan signals the beginning of a series of increases aimed at keeping the lid on the country's rampant investment growth. Another group says it's a precursor for revaluation of the yuan. A third suggests that the rate hike is Zhou's bid to nip inflation in the bud.

Zhou may have all three goals in mind. But there is another, equally compelling explanation—that Beijing is raising rates because it's desperate to lure depositors back to banks and away from the informal lending market. "The central bank is very worried about the gray market draining funds" out of the banks, says Frank F.X. Gong, chief economist for China at JPMorgan Chase & Co.

The PBOC is right to be worried. For decades the state-owned banking system has loaned recklessly to state enterprises, and the number of problem loans has

skyrocketed. Now more than ever the banks need the \$1.4 trillion the Chinese have saved. But depositors are restless. Because of rising inflation in the past year, they have been losing money on their bank savings accounts. One-year deposits still yield only 2.25% after the PBOC's October hike—well below the 5% rate of inflation. Even the least sophisticated saver realizes this is like "putting a big ice cube in the bank and watching it melt," says Dong Tao, regional economist at Credit Suisse First Boston in Hong Kong.

These negative real returns have triggered a stampede of capital into the gray market, which fills a real need by channeling capital to private businesses. This underground network can range from loans to cash-strapped businessmen by relatives and friends to sophisticated lending cooperatives formed by wealthy entrepreneurs looking for better

THE STAT

\$17
billion

The amount of money estimated to have fled China's banking system in August and September

Data: CSFB

COMMENTARY

BY JOHN ROSSANT

And Europe Thinks the U.S. Is a Mess?

The EU is so polarized that further integration may well prove impossible

EUROPEANS HAVE been transfixed these past frenzied weeks by the U.S. Presidential campaign. Given the blanket coverage from Helsinki to Lisbon, it's almost as if the 2004 Presidential elections were also being held across the European Union (where, according to polls, Senator John Kerry would be savoring a landslide victory over President George W.

Bush by now). Through it all, many Europeans have looked at the strangeness of the American political process—from the billions of campaign dollars spent and the influence of privately financed partisan groups such as MoveOn.org and Swift Boat Veterans for Truth to the tens of thousands of lawyers put on alert to challenge poll results—and are wondering whether American democracy will emerge unscathed from the ordeal.

It's not the American body politic Europeans ought to be worrying about but their own. U.S. democracy has weathered many a crisis. Europe, in contrast, is still trying to justify the existence of the European Union—and to prove its value and viability as a democratic, political construct. Yes, the U.S. is split into red and blue states. But the EU is more polarized than ever over key issues affecting its future, from admitting Turkey as a member to adopting a constitution that would vastly expand Brussels' power to set policies in economics, immigration, and judicial cooperation. The rifts are such that integration now risks becoming gridlocked. Worse, some worry that the EU itself could splinter eventually. "I'm starting to be scared," says Ulrike Guérot, a European politics specialist at the German Marshall Fund of the U.S., a public-policy think tank in Berlin.

The extent to which Europe is still a work in progress can be seen in the clash between the European Parliament and José Manuel Barroso, the President-designate of the European Commission, the EU's executive body. Barroso chose to withdraw his slate of commissioners on Oct. 27 rather than risk certain rejection at the hands of the 732-strong Parliament. Barroso's inept handling of the crisis turned a relatively minor problem—the outrage of left-wing parliamentarians over anti-gay sentiments expressed by Italy's Rocco Buttiglione, the proposed Justice Commissioner—into a bitter institutional clash. Although it was a morale booster for the directly elected Parliament, the dustup underscored



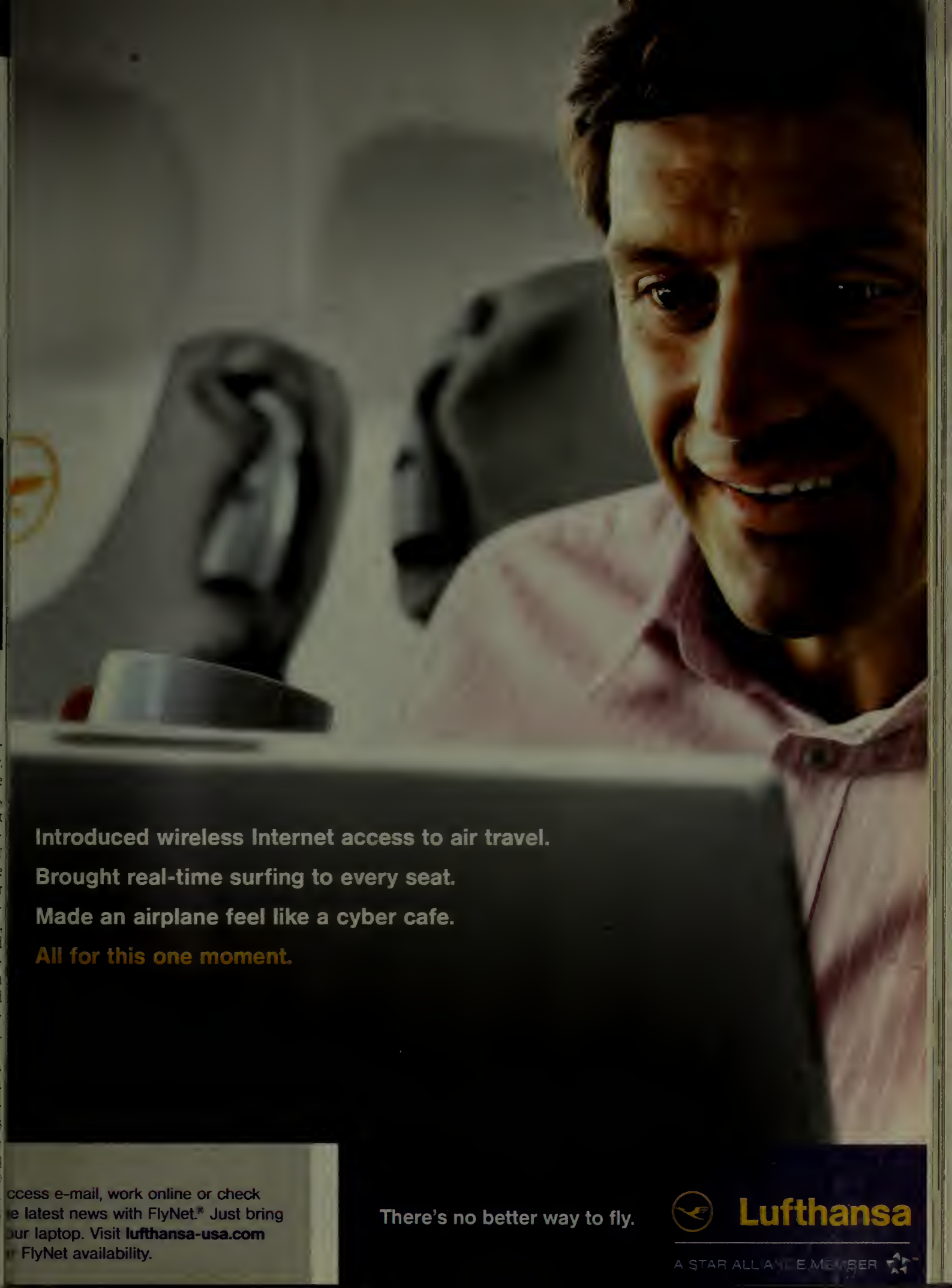
how incoherent Europe's institutional checks and balances actually are. Even as a revised commission lineup is being readied for early November, the question of how power is apportioned among the Commission, the Parliament, and national governments is more muddled than ever.

The European Constitution poses a similar problem. The signing of Europe's new Magna Carta that, among other things, gives the EU a legal personality and establishes an EU President and Foreign Minister was the occasion for a lavish Oct. 29 celebration in Rome attended by the heads of state of the 25 EU member countries. As usual, the leaders put the cart before the horse. The constitution goes into effect in 2007 and only after being ratified by each and every one of the 25 national legislatures. Nine countries—Britain, the Czech Republic, Denmark, France, Luxembourg, Ireland, the Netherlands, Portugal, and Spain—are asking voters to approve it in a series of referendums that will kick off on Feb. 20 in Spain and end in Britain in early 2006. Just one rejection and the 265-page document will have to be torn up. A large majority in Britain is already opposed, and the French are deeply divided. Rejection would likely spark a crisis.

Not a pretty picture. Even a committed pro-European like Friedbert Pflüger, chief foreign affairs spokesman for Germany's opposition Christian Democrats, now believes that Europe's constitution is dead in the water—and that Germany should part ways with France on Iraq and realign its policies with those of the U.S. So much for a common European foreign policy. The U.S. election is over. The EU's problems may be just beginning. ■

The new constitution faces referendums in nine countries

BARROSO Slapped down by the EU Parliament



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A STAR ALLIANCE MEMBER 

For Your Eyes Only, Wal-Mart Woman

Time Inc.'s *All You* shuns subscriptions in favor of the superchain's shelves

FOR TIME INC., THE WORLD'S largest magazine publisher with 134 titles, coming up with a fresh idea for a new magazine gets harder and harder.

That's because they've got something for just about everybody, from sports fanatics to celebrity gawkers to folks who live in fancy cottages. But when Time Inc. executives did some digging, they discovered an unfulfilled niche: Middle America's discount shopping crowd, mostly women. That's how *All You*, a title distributed exclusively at Wal-Mart stores, was born.

All You's mission is quite simple. Research showed that women wanted to see models of all shapes and skin tones wearing clothes from stores like Kmart and Sears. They wanted to know how much it would cost to make a recipe, per person, and how to unclog a toilet "because even if they have a man around, chances are he's not doing it for them," says *All You's* editor Bella Price, a 48-year-old British transplant who is a wife and mother of four. And just as these bargain hunters seek out good deals in the aisles at Wal-Mart, they said they wanted a low price for the magazine as well, even if it meant fewer pages and no celebs. Ring up \$1.47.

All You is one of five Time Inc. launches this year, vs. none in 2003—a sign that advertising is finally recovering. But as ads grow, so do new competing titles, one reason Time Inc. decided to push ahead with the new newsstand-only approach and

offer its least expensive magazine yet.

But why choose Wal-Mart, the biggest, baddest retailer, as sole distributor? A no-brainer, really, say Time Inc. execs, given the chain's ability to lower costs and its vast reach. Magazine-industry consultant Samir Husni estimates that the *All You* launch may have cost \$25 million, about half the bill for a more traditional magazine's debut. Time Inc. executives declined to disclose launch costs. The savings from *All You*, the first three issues of which have sold about 500,000 each, come from cutting out the newsstand wholesaler and the expensive direct marketing normally deployed to attract initial subscribers.

What's more, Time Inc. found it hard to resist the retailer's scale. Since it started selling magazines in the mid-1990s, Wal-Mart has amassed a 15% market share of all magazine sales in the U.S., making it the largest single outlet for newsstand sales. Circulation consultant Dan Capell estimates that the store racks up an even higher figure for sales of women's magazines—20% to 25%—yet another measure of the chain's increasing clout. More than 138 million people visit Wal-Mart's 3,000-plus stores every week. "I can't think of another outlet that could get this done," says Capell.

HOT POTATOES?

STILL, SOME PUBLISHERS worry that Wal-Mart's sway is too powerful in their business, going so far as to demand that magazines it deems too racy hide their content behind plastic placards. More recently, the chain ruffled Time Inc.'s sister unit, Warner Books, by canceling orders for *The Daily Show with Jon Stewart Presents America (the Book)* because of a feature showing the U.S. Supreme Court justices' heads superimposed on top of naked bodies. "Wal-Mart is a huge player in our society, in other issues from health care to minimum wage structures to labor unions to downtown development. Are those all issues that [*All You*] will never touch?" asks Michael Hoyt, executive editor of *Columbia Journalism Review*. "That will be interesting to see." *All You* execs say they weren't bothered by any potential censor-

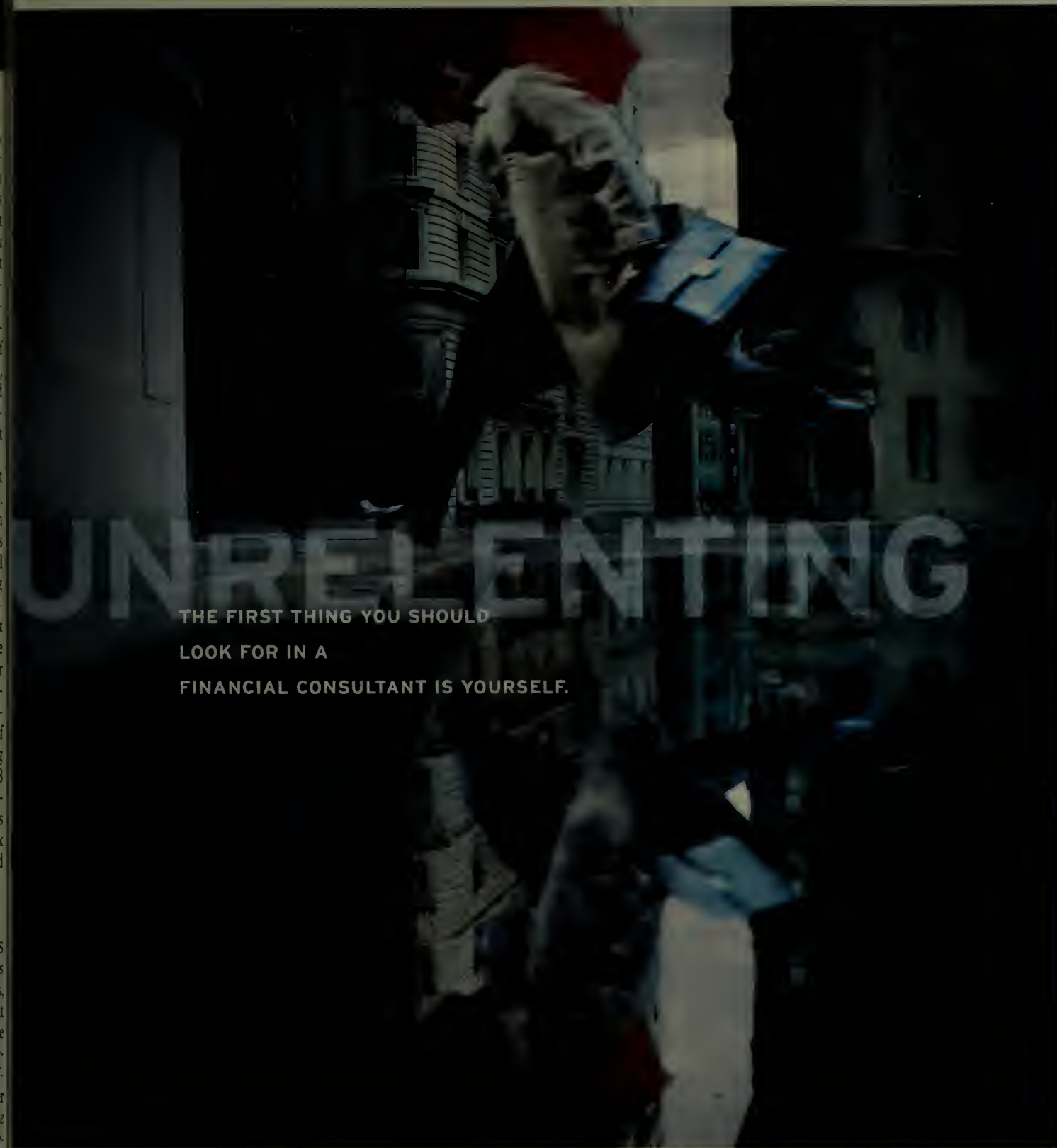


Why Wal-Mart?

What would prompt the world's largest magazine publisher to distribute a new title in just one retail chain? Four reasons:

- 1. TRAFFIC** 138 million shoppers visit one of Wal-Mart's 3,084 outlets each week
- 2. ADVERTISERS' NIRVANA** Wal-Mart accounts for 30%-plus of spending on small appliances, housewares, skin/hair care, and toys
- 3. CONCENTRATION** More than 15% of all newsstand sales of magazines occur at Wal-Mart
- 4. LOW COST** As a ready-made distributor, Wal-Mart saves a publisher up to 50% in costs vs. a traditional launch

Data: Retail Forward, Wal-Mart Stores Inc.



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ship issues. They also point out that Wal-Mart products that appear in the magazine are often on the same page as items from competitors such as Target, Kmart, and Kohl's. Wal-Mart spokesperson Karen Burk says *All You* is "just like any other magazine we offer."

Now others are rushing to follow Time Inc.'s lead by developing low-priced newsstand titles themselves. For example, American Media Inc., home to *Star*, *Shape*, and *Men's Fitness*, is set to roll out health and fitness magazine *Looking Good Now* at Wal-Mart stores in 2005 with a sticker price of just \$1.99. Hachette Filipacchi Media U.S. Inc., which publishes *Elle* and *Woman's Day*, plans to offer the women's title *For Me* only on newsstands later this year.

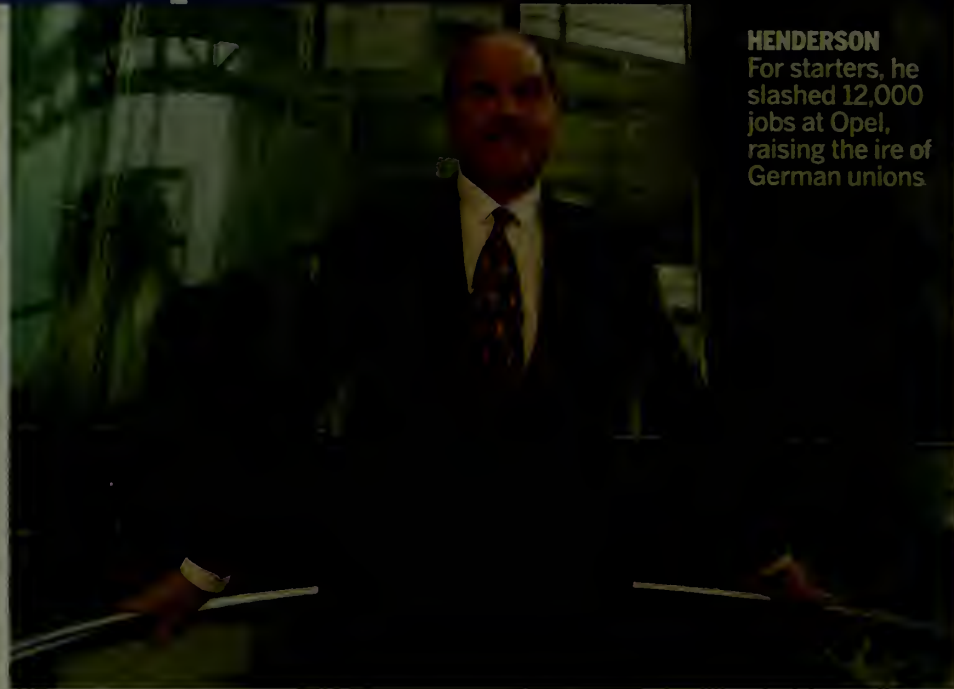
ATTENTIVE READERS

PUBLISHERS ARE WARMING to newsstand-only titles in part because studies show consumers are more attentive to advertising when they plunk down money for a magazine on the spot. "When a subscription comes in the mail, you throw it in a pile of things to do later," says *All You* publisher Diane Oshin, who confirms that *All You* ad sales are strong—30% ahead of budget so far, with 70 ad pages in the December issue. Indeed, *All You's* typical reader fits a coveted demographic: a woman in her mid-40s with a median household income of \$50,000.

Still, not all analysts are sold on the all-newsstand tack. Capell, whose newsletter *Capell's Circulation Report* shows that the 100 top magazines have lost 36% of their newsstand sales in the past 10 years, predicts that *All You* will be in the subscription biz before long, "because it's the only way to increase revenue and circulation."

Sure enough, subscription requests for *All You* have come in droves since the launch, accounting for about 40% of reader feedback, says Oshin. With numbers like that, editor Price agrees that taking on subscribers at some point will be a good thing because "Wal-Mart isn't everywhere." At least not yet. ■

—By Erin Chambers in New York



HENDERSON
For starters, he slashed 12,000 jobs at Opel, raising the ire of German unions

Toughest Job Yet For This Mr. Fixit

Stanching the red ink at GM-Europe may take Fritz Henderson quite a while

THERE ARE ROCKY STARTS in a new job, and then there's Frederick A. "Fritz" Henderson's debut as chairman of GM-Europe. On Oct. 14, a mere four months after taking his new position, Henderson announced a plan to slash 12,000 jobs from the auto maker's ailing European operations. German union workers walked out in wildcat strikes; in the Ruhr Valley town of Bochum, where General Motors Corp.'s Adam Opel has a big assembly plant, 25,000 workers marched through town in protest. Union leaders howled that GM didn't give them enough say in the restructuring. "We weren't prepared," says GM-Opel Works Council Chairman Klaus Franz.

Such a clash may have been inevitable when Motown's Mr. Fixit collided with European labor tradition. Henderson, 45, has spent much of his 20-year career parachuting into mostly troubled GM op-

erations, spending just enough time to take decisive—often painful—action, then moving on to the next assignment. For a relatively young executive, he has left a surprising number of fingerprints on key operations. A master financial analyst, he redoubled GM's bet on the mortgage business by spearheading the 1990 purchase of Residential Funding Corp., now a huge moneymaker. In 2002 he fixed near-bankrupt Isuzu Motors Ltd., which GM controlled. Most recently, Henderson played a critical role in a successful push into China.

Some GM insiders speculate that if Henderson pulls off this latest task—easily his toughest yet—he could eventually succeed Chairman and CEO G. Richard Wagoner Jr. "If you see a guy with talent, you give him a difficult assignment," says retired GM Chairman John F. Smith Jr. "If he does well, you reward him with another tough assignment."

Repairing the European operation will be plenty tough. GM has lost \$3.5 billion

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in the region since 2000. Its market share has tumbled from 11.5% in 1999 to 10%, although that has stabilized a bit lately. Opel, which suffered from a reputation for poor quality in the '90s, still has severe excess capacity. Analysts say Henderson will have to cut jobs beyond those he announced. By 2008, GM is expected to shutter either an Opel car plant in Rüsselsheim, Germany, or the Saab plant in Trollhattan, Sweden. Both are underutilized, and GM will probably pick one to make new midsize Opel Vectras and Saab 9-3s. Says Henderson: "We have been losing money for five years. We have a sense of urgency."

Typically, Henderson arrived at GM's European headquarters in Zurich with a plan already in hand. He wants to build up the Chevrolet name as his entry-level brand, define Opel more clearly as a quality mid-market offering, and import more Cadillacs to challenge BMW and Mercedes-Benz on their home turf. The first part might be the easiest: GM already sells some Daewoo-made cars under the Chevy name, priced at under \$18,000. It has made progress: In two years, Chevrolet-badged cars have grabbed nearly 1% of European sales, up from 0.6%. But Chevy still faces a steep climb.

Henderson hopes that will enable Opel's engineers, once charged with designing small cars for emerging markets all over the globe, to concentrate on higher quality, mid-market cars. Opel has already climbed back in quality, which J.D. Power & Associates Inc. says is now on par with key rivals. In fact, the new Opel Astra is widely seen as superior to the



NEW OPEL ASTRA
Off to a good start

of GM-Latin America, Africa, Middle East. "He is very much the young man in a hurry."

Volkswagen Golf. Henderson also has to push to get a real foothold for Cadillac. The SRX SUV has had some success, but GM is still opening dealerships around Europe. Soon they will begin pushing the new STS sedan.

"THAT WAS NO FUN"

HENDERSON ISN'T TAKING anything for granted—he learned that the hard way in Latin America. Only 10 months after he took over there in 1997, Brazil's economy collapsed. GM had just completed two new plants in Argentina, but industrywide car sales fell from 3 million in 1998 to 1.6 million today. Henderson had to cut payrolls and close a plant in Argentina during an election, ignoring an outcry from local politicians. With typical understatement, Henderson recalls: "That was no fun."

His response was to pile GM's resources into a new lineup of small, inexpensive cars. Henderson pushed to develop the Celta subcompact and the Meriva microvan, which was GM's first Brazilian-engineered vehicle. Today they are best-sellers, and after losing \$600 million in Latin America since 2000, GM is in the black, with a tidy \$38 million profit. "Fritz is boom, boom, and on to the next," says Richard C. Nerod, retired president

Notwithstanding his stiff-arm of the Opel unions, Henderson can be a canny negotiator. In early 2002, GM was bleeding profusely from its 49% stake in Isuzu. The truckmaker lost \$1 billion that year and was \$10 billion in debt. GM looked clueless, having poured \$450 million into the company. Henderson swiftly closed one plant in Japan, sold a 50% stake in a U.S. factory, and offloaded other businesses. But he still needed to get bankers to forgive \$1 billion in debt, with GM injecting \$650 million into Isuzu. When Daichi Kangyo Bank executives gathered in a smoke-filled conference room in Tokyo one Sunday afternoon, they told Henderson that GM's cash commitment looked weak—the financial equivalent of a balk.

Brian MacDonald, formerly a GM executive working with Isuzu and now treasurer of Dell Inc., recalls Henderson's response: "I was a pitcher in college. I balked before. I don't think I'm balking here." The Daichi bankers, big baseball fans, had to laugh at Henderson's self-deprecation. Negotiations turned more casual, and he got the deal done without having to fork over more cash, MacDonald says. Isuzu dropped its debt to \$3 billion and today is profitable.

Henderson, in fact, wasn't exaggerating about his pitching career at the University of Michigan. It was more gritty than glorious; the 5-ft.-8-in. righty could not throw hard. "He didn't have a lot of talent, but he would give you all that he had," says retired coach Moby Benedict. Even then, though, he knew when it was time to move on. A new coach came on before his senior year and offered a spot on the team—not to pitch, but to mentor freshman fireballers. "I quit," he recalls. "I just wanted to play."

Today the role of roving repairman keeps Henderson from seeing his wife, Karen, and daughters, aged 15 and 11, for long stretches. They live in Florida, while he jockeys his schedule to get home once a month. "That's the hardest part of the job," he says. "I miss my family a lot." But Wagoner isn't promising an early return from Europe. "He is going to be there for a while," the CEO says. "We need to get this business turned around." Given his frosty reception so far, Mr. Fixit may have to settle in for a long, cold winter. ■

—By David Welch in Nice, France, with Gail Edmondson in Frankfurt and William Boston in Bochum, Germany

BIO

Fritz Henderson

"If you see a guy with talent, you give him a difficult assignment," says retired GM Chairman John F. Smith Jr.

BORN Nov. 29, 1958

EDUCATION BA in business, University of Michigan, 1980; MBA, Harvard University, 1984.

CURRENT POSITION Chairman of GM-Europe since June 1, 2004.

CAREER PATH Joined GM in 1984 as a financial analyst in New York. At GMAC, made acquisitions that broadened its reach in mortgage banking. Ran the Latin America, Africa, Middle East business unit. In January, 2000, became president of GM-Asia Pacific.

HIGHLIGHTS Approved new Latin American car models that led the business to profitability. Helped revive Isuzu Motors Ltd. Oversaw a big boost in China sales.

CALLING HIM OUT He loves to talk about his days pitching at Michigan, but opposing hitters slapped him around: He had a dismal 5.91 earned-run average in his last year.

ON THE NIGHTSTAND "I hate business books. I read male trash like Robert Ludlum and Clive Cussler."

FAMILY Wife, Karen, and two daughters.





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this year, it's
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top earner

Carnival: Plenty Of Ports in a Storm

At a time when demand—and prices—for cruises are rising, it pays to be the biggest

THE SERIES OF STORMS that battered the East Coast and Caribbean late this summer sent all hands scurrying on deck at Carnival Corp. The world's largest cruise line operator had to reroute ships, change ports, and cut short some itineraries. The company figures refunds and storm-related expenses will cost it at least \$40 million in lost earnings this year. But it could have been much worse. Unlike hotels and resort operators in storm-ravaged regions, Carnival was able to cut its losses by picking up and moving its business around. "A ship is faster than a storm," says the company's chairman and chief executive, Mickey Arison.

Maneuverability is one of Carnival's greatest assets. And that means much more than just dodging storms. When the travel industry slumped after the September 11 terrorist attacks, Arison shifted boats to closer-in ports such as New York and Galveston, Tex. He also

cut fares and offered shorter cruises to attract increasingly budget-conscious travelers. Then, when rival Royal Caribbean Cruises Ltd. inked a deal to buy P&O Princess Cruises in late 2001, Arison countered with a higher bid and ultimately won the company for \$8 billion. With that deal and a bevy of previous acquisitions, Carnival now owns 12 cruise brands, a fleet of 78 vessels, and nearly half of worldwide industry revenues.

A TIGHT SHIP

Thanks in part to its penchant for deal-making, Carnival has racked up 18% average annual revenue growth over the past three years. Its stock, at a recent \$51 a share, has climbed 30% over the past year, compared with just 9% for the Standard & Poor's 500-stock index. And for fiscal 2004, which ends Nov. 30, analysts expect the cruise line to earn a record \$1.8 billion on revenues of \$9.5

billion. That performance helped Carnival sail to the No. 46 spot on this year's BW50 list of best-performing companies.

Arison has always had a gift for running a tight ship. After the P&O merger, he consolidated back-office functions in the United Kingdom, Miami, and Los Angeles, helping to generate more than \$100 million in cost savings. Later this year he plans to reconfigure one of Carnival's ships to sail under the P&O banner in Australia. The move will more than double the company's capacity in that fast-growing market to 150,000 passengers a year.

With an array of brands, Carnival can offer something for every breed of cruise fanatic. There's the high-end Yachts of Seabourn, which feature onboard lectures by Ivy League professors. At the other end of the spectrum are the Carnival "Fun Ships,"

which offer midnight buffets and dancing until 4 a.m. Carnival bought the 164-year-old Cunard Line in 1998 because of its nostalgic appeal. Indeed, the introduction earlier this year of the massive, \$800 million Queen Mary 2 caused a sensation. The first new transatlantic liner to be built in 35 years, it's now Carnival's top-earning ship. "Even Donald Trump couldn't keep off it," says Arison, referring to the ship's recent cameo on *The Apprentice*.

Arison won't be adding many more new ships to his fleet anytime soon. The weak dollar has made it expensive to build new vessels in the foreign shipyards that specialize in cruise ships. Carnival says its capacity growth will slow to





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just over 5% a year through 2007—a third the rate of recent years. With fewer new ships and demand for cruises still climbing, Carnival's pricing power is increasing. And it recently took steps to ensure it gets its fair share of the profits by prohibiting independent travel agents from rebating portions of their commissions to customers as discounted fares. The average bill for two vacationers on a seven-day Caribbean cruise, at online travel agency CruiseDirect Inc., has jumped 39% to \$1,870 since the beginning of the year.

Arison believes that compared with airfares and hotels, cruises are still a bargain and that there's room to grow. And now, the P&O merger will allow him to bring more ships to more people around the world. "In Germany they do 80 million packaged holidays a year," Arison says. "Only 250,000 of them are cruises. That number should be in the millions." Arison, of course, plans to get his share. ■

—By Christopher Palmeri
in Los Angeles

Carnival by The Numbers

Through acquisitions, Carnival has become the largest player in the industry, with a 47% share

1993	2004*
REVENUES \$1.5 billion	REVENUES \$9.5 billion
NET INCOME \$318 million	NET INCOME \$1.8 billion
NUMBER OF SHIPS 19	NUMBER OF SHIPS 78
PASSENGERS CARRIED 1.1 million	PASSENGERS CARRIED 6 million

Data: Reuters, A G Edwards, Company Reports

*Estimate

For a slide show

of the fleet of Carnival ships, go to
www.businessweek.com/magazine/extra.htm

VROOM Tiller with the hot new Predator 500 all-terrain vehicle



Lighting a Fire Under Polaris

CEO Tiller is pushing the ATV maker into new markets in a bid to boost sales

IN A WAY, A VISIT TO POLARIS Industries Inc.'s Roseau (Minn.) plant is like a trip back in time. In a town of 2,800, some 2,000 people work for the company, and rush hour along its main drag, state highway 89, occurs three times a day, when each shift ends. These days, the assembly lines putting together the company's all-terrain and utility vehicles are based on Japanese manufacturing principles, and inventory is deliv-

ered directly to the factory doors real-time—but layoffs are nearly unheard of. Many of its workers love the products so much that they drive them to work.

From Polaris' Medina (Minn.) headquarters, near Minneapolis, CEO Tom Tiller laughs that the company sometimes sounds "kind of 1950s." But that had some appeal to the 43-year-old when he decided to sign on in 1998, leaving a promising career at General Electric Co. that had him traveling to 50



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Management Strategies

countries a year. Tiller wanted to run his own company and saw a lot that he liked at Polaris. Its engineering group in Roseau had consistently turned out innovative products that had pushed it to the No. 2 spot in ATVs against such tough competitors as No. 1 Honda Motor and Yamaha Motor—and had also strengthened its sales of snowmobiles and other recreational vehicles. The company had little debt and made products that Tiller, who started snowmobiling at age 7, liked.

THE STOCK THAT ROARED

BUT THERE WAS plenty of room for improvement. Executives had missed their budget five years running when Tiller arrived, a lack of focus that had left its stock flat. For the company to grow, Tiller knew its view of what was cool had to move beyond what might be useful in the cold, flat farmland of Roseau, some 280 miles northwest of Minneapolis, to a much wider world. While he saw a chance to apply some of what he had learned at GE to goose performance, Tiller didn't want to lose the employee passion that had led to many of its breakthrough products and remarkable productivity: Polaris has revenue per employee twice that of rivals. With price tags of \$3,000 to \$10,000 per vehicle, that gives Polaris a huge boost. "How do you get a good company to the next level while protecting, nurturing this wonderful culture?" Tiller asks.

So far his answer—a blending of GE-style discipline, new blood, a focus on broader markets, and loyalty to his workers—seems to be working. Despite a growing national movement to highlight the environmental and safety problems posed by ATVs and snowmobiles, the company is thriving. Under Tiller, sales have risen from \$1.2 billion in 1997 to an estimated \$1.8 billion this year. More impressive, net income has climbed from \$31 million to an estimated \$135 million. Heartened by 26 straight quarters of meeting or beating expectations, shareholders have bid the stock up 274% during Tiller's tenure, compared with a 12% drop

for the Standard & Poor's 500-stock index.

Supporting that performance have been a number of home-grown leading-edge products—starting with the hugely popular Sportsman ATV, which enthusiast engineers created in the mid-1990s by adding independent rear suspension to a classic ATV.

But the process of creating new products at Polaris had been seat-of-the-pants. The Ranger utility vehicle, a cross between a jeep and a golf cart that can hang on to a hill at something that feels close to a 90-degree angle, went through two development cycles, first as a six-wheeler then as a popular four-wheeler. Yes, Polaris ended up with a great product, but Tiller wanted to make the process more efficient. Now he ties development to market research, much of which is

New Polaris facilities are near big cities to lure top talent

done far from the Midwest.

He has also funded a new research-and-development center, scheduled to open next year in Wyoming, Minn., closer to Minneapolis, in the hopes of attracting a broader range of engineers and designers. Tiller says they currently have to interview 100 engineers to

fill a single job opening in remote Roseau. Tiller has also imported executives from big companies like Honeywell, General Mills, and GE, and has brought compensation up to more competitive levels. "Before, we were constantly looking for diamonds in the rough," says Bennett Morgan, a 17-year veteran who oversees the company's largest division, its \$1.1 billion ATV business.

The development of the Predator 500 is a model of what Tiller is moving toward. Introduced in 2002, it's an ATV aimed at the sports and recreation market with a buglike front panel and easy-to-spot front shock absorbers, which improve its ride and handling, and deep-tread radial tires. From the beginning, the Predator, which retails for \$6,200, followed a different path from vehicles such as the Sportsman, which had been born, tested, and produced in Roseau. To perfect the Predator, meant for use on a lot of terrains including desert, managers conducted field research in the sand dunes of Southern California, with prototypes wrested from the engineers earlier than usual. The idea was to make sure they were on the right marketing track. And the testing led to changes, including enhancing the more angled, buglike look.

To reach the fashion-conscious sports enthusiasts, Polaris launched a viral marketing campaign with provocative postings on enthusiast Web sites such as "Honda for sale, Predator coming." The company would sneak vehicles into popular testing grounds, where leading-edge riders began to agitate for sneak peeks. Predator captured 15% of its segment of the market during its first year, according to Polaris, compared with 1% to 2% for a typical new entry.

Tiller would like many more such wins, and has set a goal of reaching \$3 billion in sales by 2009. To get there he wants waves of new products in a leaner, more profitable dealer network with a global expansion that is already starting in Western Europe. The French Alps are a long way from Roseau, but Tiller thinks Polaris is ready for the move. ■

—By Nanette Byrnes in Roseau, Minn.



Revving Up the Engine

When Tom Tiller left General Electric to run Polaris Industries, he wanted to make a good company great. Here's how he's doing it:

THE GE WAY Among the things Tiller imported from GE are equipment financing and nine-part performance reviews for his staff. As at GE, bonuses depend as much on embracing company values as meeting your numbers.

BETTER LEADERS To build his management team, Tiller promoted from within and hired highly skilled people from GE and General Mills. His bench now includes several potential successors.

CULTIVATING INNOVATION New-product ideas and improvements have long come from a staff that's passionate about Polaris gear—for instance, the seven-position steering on the 900 Fusion snowmobile (above). Next year a new research center opens near Minneapolis.



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\$1.4 trillion in U.S. institutional investment products were benchmarked to the S&P 500 in 2003; source Nelson's MarketPlace Web database. \$2.1 trillion in U.S. equity retail funds were benchmarked to the S&P 500 in 2003; source Morningstar, Inc. \$1.1 trillion in U.S. assets were directly indexed to the S&P 500 in 2003; source Standard & Poor's Survey of Indexed Assets. Standard & Poor's does not sponsor, endorse, sell or promote any S&P index-based investment product.

The Long Arm of Failure

Lawyers are aggressively suing on behalf of bankrupt companies to recoup money paid to creditors

CRAIG KING WAS PLENTY disappointed when Trans World Airlines Inc. filed for bankruptcy in 2001 still owing him \$7,400 for building a break room and installing ticket counters at Anchorage International Airport. It was only the second time in the 19 years as owner of a small construction company in Alaska that a customer hadn't paid him in full. But King's hurt was just beginning. Nearly two years later, TWA lawyers slapped him with a lawsuit for the return of an initial \$10,000 the airline had paid him for the work seven weeks before it went bust. King was given a choice: Pay back 80% of the money or fight the case in a Delaware court. "I was flabbergasted," says King.

Thousands of suppliers are feeling just as dumbfounded now. Like King, they have been hit by lawsuits filed in the names of bankrupt companies by lawyers working for contingency fees, typically 33% of what they recover. The preference actions, as they're called, seek to reclaim money the debtors paid out in the 90 days before they filed for bankruptcy. They're based on the centuries-old legal principle that no creditor should get preferential treatment, especially those who were paid when the deadbeat company was about to go to court. Such suits are growing fast: Last year they totaled some 60,000—nearly three times as many as in 1999, according to the Administrative Office of U.S. Courts.

A string of mega-bankruptcies has spurred the surge. Last year, the failure of Bethlehem Steel Corp. alone spawned more than 3,000 lawsuits, plus 1,300 letters demanding repayments. Thousands more suits flowed from the collapses in 2001 and 2002 of Enron, WorldCom, and 360networks. Now, UAL Corp., parent of United Air Lines Inc., is gearing up to file



as many as 2,500 suits before early December, when the two-year statute of limitations on its claims runs out.

LOW-COST CLAIMS

BECAUSE OF THE WAVE of cases, suppliers are getting more leery about giving credit. Already, they're backing away from giving struggling customers extra time to pay because the law, perversely, guts their defenses if they have made an exception to their usual payment terms. "The specter of [lawsuits] is reshaping

business credit policy," says Robin Schauseil, president of the National Association of Credit Management (NACM), a creditor trade group that has been lobbying for years to reform bankruptcy law.

Advances in technology are adding to a sense of unease among creditors. Thanks to widespread electronic record-keeping, versatile computer software, and broadband connections, it's easier than ever for lawyers to pursue claims. And some attorneys seem to operate on an industrial

cale: In the Bethlehem Steel case, one firm, Gazes & Associates LLP, fired off 5,500 lawsuits and 1,300 letters in just nine weeks.

Technology has also dramatically cut the cost of preference actions. Jack B. Fishman, a lawyer and president of bankruptcy-services firm Novare Inc., says he will now go after amounts as small as \$500, compared with the \$10,000 minimum lawyers used to require. Because it costs \$150 to file a case in court, he first sends letters demanding repayment. Fishman was recently hired by UAL's bankruptcy lawyers to help retrieve as much as \$450 million paid in

the current law, defendants have to show why they should keep the money. So suits for less than \$10,000 are rarely worth fighting. Shelling out cash to settle often makes more sense. "It has become abusive," says Robert P. Simons, a bankruptcy lawyer at Reed, Smith LLP in Pittsburgh who represents suppliers caught up in the series of recent steel industry bankruptcies. "The pressure is on the defendant to cut a deal."

Mounting a viable defense to preference actions is difficult. For starters, creditors often have to deal with letters and lawsuits that demand the return of a sum total of payments without saying exactly when they were made, for what, or by which of the debtor's operating units, says Kelton Farris, vice-president for collections at Premium Assignment Corp., an insurance finance unit of Suntrust Banks Inc. About once a month, he receives a demand for repayment from lawyers who have apparently downloaded his address with others from the old check registers of bankrupt companies. "They deal in such volume that if you call them, you're lucky to get a call back within a week," says Farris.

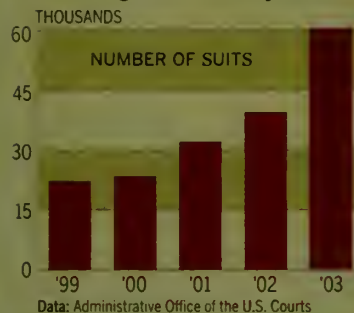
Lawyers who bring the cases counter that they're following professional standards and use the law and modern technology quite legitimately to help bankrupt companies.

UAL is gearing up to file as many as 2,500 suits

Ian J. Gazes of Gazes & Associates argues that the claims he pursues help make the bankruptcy process fairer by retrieving money from creditors who by luck or by inside information get paid ahead of others. Fishman says it's sometimes difficult for lawyers filing suit to provide the detail some of the defendants seek. On occasion, he says, there isn't time to track down the particulars of the payments before the statute of limitations runs out. At other times, the bankrupt company's records are a mess.

DUNNED BY THE DEBTORS

A growing number of creditors who received payments during the three months before a company went bankrupt are being sued to give the money back.



As more companies securitize their assets, the arguments become even more bitter. Bankrupt companies have often pledged a large chunk of their assets to secured creditors. As a result, there are fewer sources of cash left to pay the lawyers except for the preference actions. "They're a hidden source of funding for many bankruptcy cases," says a lawyer who asked not to be named because he is defending suppliers of sever-

al of the big bankrupt companies.

For years, the NACM has been pushing to change the law. The fixes it seeks include setting a minimum threshold for lawsuits, shifting the burden of proof to plaintiffs, and shortening the "clawback period" to 30 days from 90 days before a bankruptcy filing. Although the reforms have general support on Capitol Hill, NACM President Schauseil says they've been held up in a stalemate over consumer issues in a pending overhaul of the bankruptcy code.

LITTLE ACCOUNTABILITY

REFORM MIGHT HAVE COME sooner if it were clearer exactly how much money is recovered and by whom under the existing law. Suits often linger for years after companies are liquidated or are out of bankruptcy. "There's little public accountability," says Thomas D. Goldberg, a lawyer for trade creditors at Day, Berry & Howard. "Trying to find out how much has been recovered and what the benefit is to whom is almost impossible in most cases."

That's certainly true for TWA and the money returned by Anchorage's King. He paid \$1,500 to a local lawyer who put up such a stink in settlement talks that King had to pay TWA only \$1,500. But King doesn't know what became of that money. Lawyers for the TWA estate declined to discuss the case. Bankruptcy court documents filed in 2002 indicate that at least 96.7% of preference recoveries would go to lawyers and other priority creditors of TWA. Unsecured creditors such as King would share no more than \$4.8 million, or just a quarter penny for every \$1 they were owed. With odds like that, it's no wonder creditors believe the law prefers the lawyers. ■

—By David Henry in New York

the fall of 2002 before it filed for bankruptcy. Small cases add up, he says, figuring that if he can get 2,000 defendants to cough up an average of \$5,000, he'll bring in \$10 million. "I have no qualms about what I do," says Fishman. "I've been called everything from extortionist to scam artist."

Indeed, some suppliers say many preference actions are little more than legally sanctioned extortion. For one thing, even as the cost of making claims is falling, the expense of fighting them is rising. Under



Big Stick At the Big Board

NYSE regulators are on a mission to restore the exchange's credibility

LAST YEAR, MORGAN STANLEY voluntarily fessed up to the New York Stock Exchange that its stock-trading program had suffered technical glitches. Because it was up front, Big Board regulators say the firm asked them to cut it some slack. Instead, in December the brokerage was fined \$800,000.

The Wall Street firm got an even bigger shock in September. Not only had Morgan Stanley failed to fix the trading system but

it also had hit new supervisory and operational snags. Among other things, it omitted to send out prospectuses to about 100,000 clients for some 3,000 different investments. So NYSE regulators slapped it with a \$19 million fine, breaking the record set when Drexel Burnham Lambert Inc. was hit up for \$2.5 million in 1992. Morgan Stanley, which agreed to the penalty in principle, said it had reported the problems and fixed them.

Big Board regulators are on a tear. Their mission is to restore the credibility

LESS CLUBBY Enforcement chief Ketchum's team is more diverse than in the Grasso days

of the NYSE's enforcement efforts after the battering the 211-year-old exchange received under disgraced former Chairman and Chief Executive Richard A. Grasso. It's a crucial part of new Chairman John Reed's efforts to make a break with regulatory scandals and prepare the NYSE for a raft of challenges, including sharp competition from electronic exchanges. Reed wants to keep regulation in-house and not cede control to an outside regulator, as some critics want.

BIG NET

LEADING THE CHARGE is Chief Regulatory Officer Richard G. Ketchum, who was hired in July. In an exclusive interview with *BusinessWeek*, Ketchum and his top lieutenants outlined for the first time how they aim to restore the NYSE's place as watchdog of the world's largest marketplace. Here's what his team has done in three months:

- Issued stiffer penalties more often.
- Dusted off old rules that will lock persistent offenders out of lucrative businesses, such as the initial public offering market, for a set time.
- Spent more on technology to modernize market surveillance and better monitor trading by member firms.
- Sent out enforcers with investigators for the first time to expedite cases and get restitution to investors faster.
- Created a Risk Assessment Team to scour for misdeeds before they turn into full-blown scandals, tapping new sources such as arbitration filings.
- Set up an e-mail task force to set standards for how Wall Street should monitor and preserve internal and external communications.

In a major change, repeat violators will be dealt with harshly. Ketchum hopes to influence the behavior of Wall Street firms by, for example, showing them that if they don't do the right thing, they face higher fines. "We've got to make sure the penalties are sufficient so members won't treat them as a cost of doing business," says Ketchum. NYSE enforcement chief Susan L. Merrill adds that she'll also impose sanctions if firms don't fully reimburse investors for bad advice or fraud. "The



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whole idea is to make customers whole," she says.

Ketchum is spreading the regulatory net into entirely new areas. For the first time, his team will scrutinize brokerages that trade big blocks of shares for mutual and pension funds. It will also look closely into whether brokers handle orders near the close of the market fairly. It is mulling a rule to force Wall Street firms to acknowledge receipt of a customers' complaint within 15 days. There's no such requirement now. And if the NYSE has its way, all brokers, no matter how long they've been in the industry, will have to participate in ongoing education. Until now, veteran brokers were often exempt from annual certification. "We're moving faster; the stakes are rising," says Grace B. Vogel, the new head of member firm regulation who was recruited from Citigroup in June.

Under Ketchum, the NYSE is looking a lot less clubby. His top cops include two women—Vogel, 48, and Merrill, 47—as well as an African American, Robert A. Marchman, 46, a former branch chief of the Securities & Exchange Commission who joined in September as head of market surveillance. Marchman led the recent investigation into seven specialists for alleged improper trading that resulted in \$247 million in fines. "We want to deal with issues before they become widespread, and we've been empowered to do that," Marchman says.

The new mod squad has a much bigger staff than in Grasso's era. So far this year, they've hired 67 more investigators and lawyers, pushing the total regulatory staff to 700—42% of the NYSE's workforce. The team is responsible for oversight of 160 specialist and floor broker firms and the nation's 230 biggest securities firms, which manage more than 90% of all investor brokerage accounts. "I can assure you that the enforcement

staff is not cozy with the members," says Merrill, who was hired in July. "They have a real prosecutorial mentality."

Firms that obstruct the enforcers can expect tough justice. On Aug. 26, for example, Deutsche Bank was fined \$7.5 million by the SEC, NYSE, and others for not producing e-mail records in a timely manner. That fine was more than four times those imposed on five other Wall Street firms that paid up for not having proper systems to keep e-mail in December, 2002. Deutsche Bank says it has solved the problem. The Morgan Stanley case shows that nobody gets "extra credit" for admitting to mistakes

when it's required by law to do so anyway, says Merrill. "The prospectus is a key document in securities law that lays out risk factors to investors. It's not a sales pitch," she says. "Morgan Stanley showed several operational breakdowns and that concerns me greatly."

Since Ketchum, 53, was recruited in June, the enforcement and market surveillance budget is up by \$50 million. Ketchum, previously the general counsel for Citigroup's corporate and investment bank, was also president of NASDAQ Stock Market Inc. and spent 14 years at the SEC, eight as the director of market regulation. "If self-regulation is going to work, it must show that our decisions are irrelevant to whether it helps or hurts the NYSE as a business," he says. "The proof is how quickly we react to red flags and go after the conflicts [of interest] that are undeniably there."

The early response to his efforts is favorable. Many specialists, former regulators, and industry mavens say they believe the new regime is moving in the right direction. "There's no question that

Critics doubt the NYSE can really regulate itself

in my practice we are seeing a more active NYSE both in the surveillance and particularly enforcement," says Neal Sullivan, partner at Bingham E. McCutchen in Washington, who often represents Wall Street in securities regulation cases. "They are just much more aggressive—pushing issues, getting documents, trying to ferret out deficiencies."

But Ketchum's reforms don't placate everyone. Critics of the NYSE's status as a self-regulatory organization (SRO) say the old klatsch of members who own the exchange will always act in their own self-interest. American Enterprise Institute fellow James K. Glassman argues that the SEC should force the NYSE to have an independent regulator. "I am extremely skeptical that any institution can absorb a regulator within itself and truly self-regulate," he says.

Ketchum's critics point to the NASD, a private entity with an annual budget of \$400 million and a staff of 2,000. It now regulates the NASDAQ Stock Market, of which it used to be a part, and more than 5,200 securities firms. The SEC imposed the separation as a remedy after serious trading improprieties emerged in 1996.

WAIT AND SEE

THE SEC IS EXPECTED to weigh in on the debate. So far, Washington sources say agency staffers have adopted a wait-and-see approach but are optimistic about Ketchum's progress. On Nov. 9, commissioners will vote on whether to propose a rule covering transparency and governance in self-regulated markets. It will issue a discussion paper to explore alternatives to the NYSE's SRO status soon after. One possibility: Combine the NASD and NYSE regulation, saving as much as \$100 million a year. NASD officials declined to comment. Ketchum is not keen on the idea. He says NYSE regulators understand the nuances and intricacies of NYSE trading better—but he's all for sharing training expenses and rulemaking.

If Ketchum and his team succeed in restoring the NYSE's reputation, they'll face an even stiffer test. "The real question is what's the next problem that's going to crop up," says James J. Angel, associate professor of finance at Georgetown University. In short, Ketchum's job will be to make sure the next scandal never happens. ■

—By Mara Der Hovanesian
in New York

Playing Hardball

The Big Board is toughening up the way it polices the market:

STIFFER FINES

In September, Morgan Stanley was hit with a \$19 million fine for a variety of violations, the largest since 1992, when Drexel Burnham Lambert paid \$2.5 million

NEW PENALTIES

The NYSE is reviving old rules that ban violators from doing lucrative business, such as IPOs, for a given time depending on the seriousness of the infraction

MORE COPS

An additional 67 investigators were hired this year, bringing the regulatory staff to 700

BIGGER BUDGET

Spending on enforcement, technology, and market surveillance rose by \$50 million this year

CHINESE WALL

The chief regulator now reports to a new committee of three independent board members, instead of the NYSE chairman as in Richard Grasso's time

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Crude Lessons About Oil

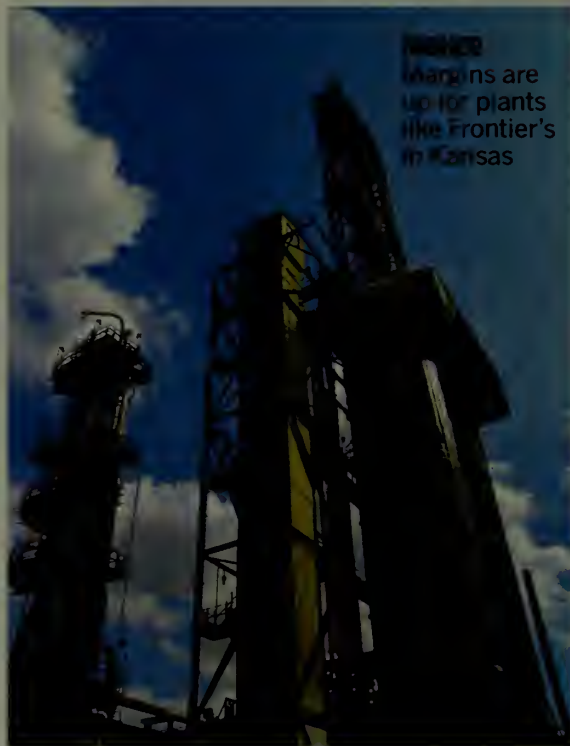
Low-quality \$35-a-barrel oil is plentiful—but refineries lack the capacity to handle it

ALL CRUDE OIL IS NOT created equal. No one knows that better than the world's refiners. The markets generally track a type of oil referred to as "light, sweet" crude.

But while this fast-flowing, low-sulfur variety is in tight supply and goes for roughly \$50 a barrel, there's a veritable ocean of thicker, lower-quality crude being pumped out by Saudi Arabia, Mexico, and others that currently sells for as little as \$35 a barrel.

The problem is that the world can't just switch from one to the other. "Heavy, sour" oil is more complex and costly to convert into useful products such as gasoline and heating oil. And much of the world's refining capacity, particularly in Asia, simply can't process it. "There's no shortage of crude oil today," says Thomas D. O'Malley, chairman of Premcor Inc., a refiner based in Old Greenwich, Conn. "There is a shortage of light sweet."

The result is that the price of oil—and of products made from it—is higher and more volatile than it might be if there were more capacity for handling the heavy, sour stuff. In the meantime, refiners that specialize in the cheaper grades—such as Valero Energy, Premcor, and Frontier Oil—are reaping rich rewards. Valero Energy Corp. figures that lower-cost oil, together with higher refining volumes, helped boost its third-quarter income by \$480 million. "It's a way we can increase our profits, but it doesn't cost consumers



a penny more," says Valero spokeswoman Mary Rose Brown.

These higher profit margins are beginning to cause refiners to switch over existing capacity to handle the growing flow of lower-cost crude. New oil coming to the market from such places as Saudi Arabia, Russia, and Canada is increasingly of this type. But upgrading existing refineries to handle low-grade crudes can cost hundreds of millions of dollars per facility and take several years. That's a tough sell in a historically low-margin, cyclical in-

dustry. Timothy M. Donohue, a principal at Booz Allen Hamilton Inc., figures the \$8 to \$10 per barrel discount for heavy crude would have to remain for up to seven years to justify a large-scale shift.

REFINED REFINERIES

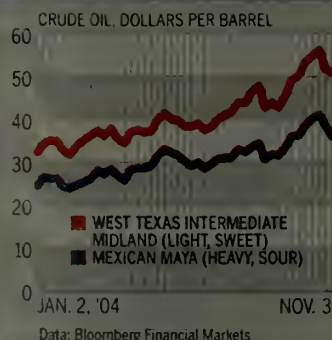
INDEPENDENT REFINERS such as Valero are willing to take risks. Unlike big integrated oil companies, such as Exxon Mobil Corp., which control about one-third of U.S. refining capacity, independents don't have their own oil supplies. So while Valero already depends on heavy and sour grades for 70% of the oil it refines, the company wants to handle more. Last year the San Antonio-based company spent \$340 million upgrading its Texas City refinery near Houston to allow it to handle greater volumes of the low-cost oil, thereby reducing the cost of its feedstocks, says Senior Vice-President Gene Edwards. Premcor is following suit by upping its capacity for low-grade crude by 30% with a \$250 million investment in its Port Arthur (Tex.) plant.

Increasing refiners' ability to handle heavy, sour crude, while important, won't dramatically boost industrywide output. For that, industry experts say, what's needed is investment in brand-new refining capacity—and few major additions are in the works. Even refiners' healthy profits of late don't justify the multibillion dollar costs of a new refinery, says analyst Jeffrey A. Dietert of Houston-based investment bank Simmons & Co. International. "In the long run," says William Hauschildt, vice-president of refining operations for ChevronTexaco Corp., "refining hasn't matched the return on capital employed compared to other industries."

As a result, analysts expect refining capacity to stay tight—and margins healthy—for the next few years. Analyst Jacques Rousseau of Friedman, Billings, Ramsey & Co. predicts that total U.S. refining capacity will grow by only 0.5% a year from 2004 through 2006. Meanwhile, U.S. demand for gas and other refined products will grow by 1% to 1.5% per year. Imports will take up the slack, but overseas refining capacity is expected to grow more slowly than demand, too. No matter how you look at it, heavy, sour crude won't offer consumers sweet relief from rising oil prices anytime soon. ■

—By Wendy Zellner in Dallas

SWEET AND SOUR





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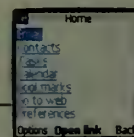
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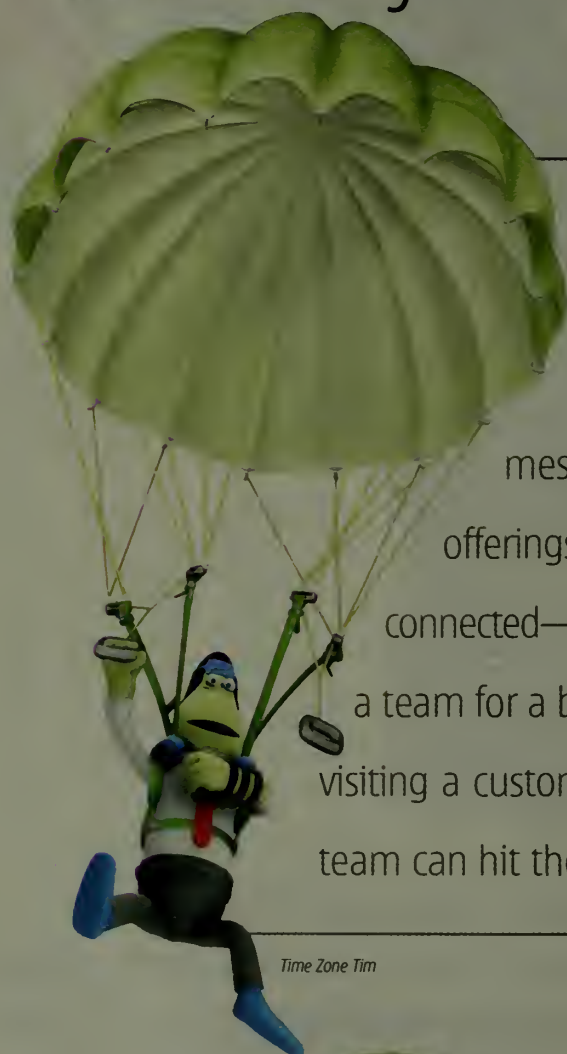


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INNOVATIONS

Happy talk and the power of veggies

» "Forget your troubles, c'mon get happy." These truly are words to live by. Dutch scientists questioned 941 men and women aged 65 to 85 in generally good health about their attitudes toward life, then tracked them for a period of nine years. Patients who described themselves as highly optimistic had a 55% lower risk of death from all causes and a 23% lower risk of death from heart disease than those who were highly pessimistic, the scientists report in the November issue of *Archives of General Psychiatry*. "A predisposition toward optimism seemed to provide a survival benefit," the authors noted.



» On the other hand, eating your vegetables will do only so much good, despite widespread assumptions to the contrary. Harvard University researchers analyzed data on more than 100,000 participants in two large, multiyear health surveys. They report in the Nov. 3 issue of *Journal of the National Cancer Institute* that patients who ate five or more servings of fruits and vegetables a day had a lower risk of heart disease, but their healthy diets did nothing to lower their risk of cancer.

ALTERED FOODS

KEEPING TOMATOES FROM KILLING THEMSELVES

TOMATOES are not an easy crop. They are vulnerable to a disease spread by aphids called cucumber mosaic virus (CMV), which can cause the plants to turn brown and die. Tomatoes are also sensitive to cold. Whole crops can be wiped out on a single frosty night.

Scientists at the Samuel Roberts Noble Foundation, an agricultural research institute in Ardmore, Okla., may have discovered a way to protect tomatoes from both CMV and low temperatures. A parasite associated with one form of CMV touches off apoptosis, or programmed cell death—a natural process that prompts cells to commit suicide for various reasons. The researchers showed that they could grow tomatoes



resistant to the parasite by inserting a specific gene from either humans or worms into the plants. The inserted gene makes proteins that counter premature apoptosis, rendering the CMV virus harmless. The gene-treated tomatoes also seem to tolerate cold better than their naturally grown counterparts.

—By Arlene Weintraub

BIOTECH

A PILL THAT SPURS RED BLOOD CELLS

TWO OF THE best-selling biotech drugs are Amgen's Epogen and Johnson & Johnson's Procrit, treatments for anemia associated with kidney failure and chemotherapy. Approved in 1989, these two injectable drugs bring in combined sales of about \$5 billion a year in the U.S. Now a privately held biotech firm in South San Francisco, FibroGen, is challenging the two giants with a pill version that is attracting notice in

both scientific and investment circles. Epogen and Procrit are synthetic versions of erythropoietin (EPO), a human protein that prompts the production of red blood cells. The drugs are typically injected twice a week. FibroGen's oral drug, FG-2216, stimulates the body's own EPO production. In a Phase I study involving 68 healthy men that was presented Nov. 1 at the American Society of Nephrology's annual meeting, FibroGen said its drug increased production of both EPO and red blood cells, with no serious side effects.

ROBOTS

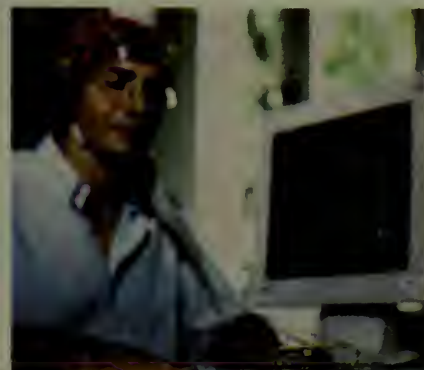
THIS WHEELCHAIR RUNS ON BRAINWAVES

CONTROLLING machines with the mind sounds like something out of an Isaac Asimov story, but a team of European scientists is getting closer to making this science-fiction scenario a reality. Project MAIA, based in Martigny, Switzerland, has unveiled technology that allows people to guide a tiny robot wheelchair by thought alone, through a cap studded with electrodes that read brainwaves.

Unlike earlier electrode-based systems, this one doesn't require surgery—or even a haircut. Human thoughts create impulses in specific areas of the brain. Simply thinking about moving left, for example, creates such an impulse. Project MAIA's device utilizes electroencephalograms to quickly convert these signals into a corresponding action in the wheelchair.

This is the first noninvasive system that can control a robot, says José del R. Millán, senior researcher at IDIAP Research Institute in Switzerland and lead scientist on the project. Two people tested in early trials achieved a success rate of 70% to 75%, the researchers report. The project is set to run until 2007.

—By Rachel Tiplady





GREEN "We want to become part of the fabric of the industries we serve"

Accenture's New High-Wire Act

CEO Green is going after bigger, longer contracts—and guaranteeing results

IN LATE 2000, STORAGE GIANT EMC Corp. was battening down the hatches for the tech tsunami that lay ahead. But a project to install a critical new software system at the Hopkinton (Mass.) company had fallen behind schedule, threatening to hamper its operations. So EMC's then-Chief Operating Officer Joseph M. Tucci put a call into William D. Green, chief of the tech group at Accenture Ltd., the consulting firm managing the installation. Could Green help? The Accenture

exec took over the project himself, pulled in three senior partners to help the one who had been on the job, and stayed in regular contact with Tucci to make sure things were on track. The result: EMC had the software to coordinate manufacturing, sales, and finance in place by the original deadline of October, 2001. "He went over and above," says Tucci, now EMC's chief executive. "He will find a way to get his goals done and make you happy."

Now Green faces the ultimate challenge. In September, the 51-year-old son

of a plumber became CEO of Accenture, the world's second-largest stand-alone consulting company. In his first in-depth interview since, the little-known exec laid out his ambitious vision to remake the tech consultant. The crux of his plan is an audacious concept he calls "high-performance business." The idea is that Accenture will dream up and build services so powerful and so exceptional that they will be required to compete in any industry, from financial services to manufacturing. Green figures that if Accenture can deliver, the firm will be able to produce double-digit earnings leaps and revenue growth that outstrips the tech-services industry. "We want to become part of the fabric of the industries we serve," says Green. "How do you become the de facto standard for a set of products or services that an industry uses to operate? How do you become not optional?"

A GRAND VISION

ONE WAY IS to put skin in the game. Traditionally, tech consultants have helped companies install computer systems and got paid for getting the gear in place. Green is trying to lead a shift away from using tech for tech's sake and instead use it to achieve specific business goals. Want to cut costs 25%? Improve customer satisfaction 10%? Accenture will guarantee that you get there—or forgo a chunk of its pay. Under a contract with British travel company Thomas Cook, Accenture's bonus depends on reaching five metrics, including cost-cutting targets. So far, so good. "We're achieving a greater level of productivity than our competitors," says Ian Ailles, managing director at Thomas Cook. Today, 30% of Accenture's contracts include quantitative measures—and that number is growing.

Green is betting big that Accenture can become the must-have adviser for Corporate America. The company is boosting research and development and adding staff by the truckload. It raised headcount by an astonishing 20,000 during the fiscal year ended on Aug. 31, to 103,000 employees. It expects to add another 20,000 workers by next August. It's also bidding for multiyear, multibillion-dollar contracts that are much larger than those the firm has taken on in the past. Such contracts have become major money-losers for some rivals. But Accenture believes that, by blending outsourcing and other work, it can provide even more value to its clients.

Such a grand vision would be no small feat in the best of times. But Green is assuming control during a period of sweeping change. The tech-services industry has

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OBVIOUSLY, MAKING A QUICK BUCK
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been whipsawed as the red-hot demand of the late 1990s turned into the deep freeze of the past few years. At the same time, competition is getting fiercer. A pack of scrappy rivals from India are starting to encroach on Accenture's turf, big kahunas such as Hewlett-Packard Co. are entering the market, and Green's most fearsome rival, IBM, is pushing hard to convince clients that its legions of scientists and engineers make it a more valuable partner than any stand-alone consultant. "Our competitors don't have the capabilities to address the market the way we can," says Laurie Tropiano, an IBM vice-president.

UNLIKELY CAPTAIN

CAN GREEN DELIVER on his ambitious plans? An industry downturn or a problematic megacontract certainly could trip him up, but early signs are promising. Clients say Accenture already is proving itself an invaluable partner in everything from drug development to asset management. And as the firm adds staff and invests in research and development, its momentum is likely to continue. Goldman, Sachs & Co. expects the firm to boost revenues 11% over the next fiscal year, to \$15.1 billion, while increasing net income 11%, to \$1.35 billion. "You have to know the client's business well, and that's what Accenture does better than anyone," says Goldman analyst Gregory Gould.

Green is an unlikely captain in the cerebral world of consulting. Born into a close-knit Irish family in Hampden,

Mass., he showed more aptitude for hard work than schoolbooks as a kid. Since the age of 9, Green took odd jobs, looking after horses and working with electricians. The first in his family to go to college, he almost didn't make it. He worked in construction for a year after high school before enrolling in a small two-year school, Dean College. It was there that Green began to show his potential.

"He was soaking up ideas like a sponge," says Charles M. Kramer, who taught Green economics. Green later earned an economics degree and an MBA from Babson College.

At Accenture, the only place he has worked since college, Green has succeeded by bucking conventional wisdom. He was a proponent of outsourcing 15 years ago, when few at the firm believed in the nascent business. That helped Green report healthy revenue hikes for the New England office he ran at the time, despite the recession of 1990-91.

That's the kind of bold thinking Green needs to make his high-performance initiative pay off. The concept grew out of a research effort that found that fewer than 1 in 10 companies outperforms its peers over a 10-year period. The goal is to use Accenture's business and tech knowhow to help clients become those superstars.

Here's the tricky part: There's no

cookie-cutter recipe. Accenture needs to develop a unique formula for each client. That begins with defining the factors necessary for superior performance in a client's industry and then leads to a detailed blueprint for how a particular client can climb to the top of its hill.

While the concept is still new, Accenture is delivering results for some pilot clients.

The firm started working with pharmaceutical giant Wyeth in 2001 to find ways to improve its performance. They quickly agreed that a key factor for success was the pace of drug development. That led Accenture to create scorecards that hold Wyeth scientists accountable for meeting research objectives. The consulting firm also took over the process of managing clinical trial data—the first time a drugmaker has entered into such a deal.

The result? Wyeth is now moving 12 drugs into development every year, up from three in the past. The results have "really been phenomenal," says Robert R. Ruffolo Jr., Wyeth's research president.

The riskiest part of Green's strategy is his determination to win larger, higher-profile deals. Such contracts require multimillion-dollar up-front investments—and payments can be delayed because of faulty technology, poor performance, or government red tape. Huge losses can result. Rival Electronic Data Systems Corp. took a \$559 million hit on one contract with the U.S. Navy and said that toll could rise with its quarterly earnings announcement on Nov. 5. While Accenture hasn't had any serious problems, it's too early to tell how the firm will fare. "Accenture is in a honeymoon period," says analyst Frances Karamouzis of researcher Gartner Inc..

Green is well aware of the high wire. That's why one of the first things he did was appoint former high-tech operating group COO Robert N. Frerichs to a newly created job: Chief Quality & Risk Officer.

It's quite a balancing act. But Green is confident in his strategy and his army of consultants. "I would never trade our hand with anyone," he says. Now he'll have to parlay that hand into a winning performance. ■

—By Spencer E. Ante in New York

More and more, the firm sets specific goals to be reached—or it forgoes a chunk of pay

An Audacious Game Plan

To help make hiring Accenture "not optional," CEO Green is implementing several key changes at the consulting giant.

HIGHER PERFORMANCE Green is championing a new strategy he calls "high-performance business." The idea is that Accenture will use its business and tech knowhow to help clients become superstars in their industries.

MORE COOPERATION He is pushing employees to cooperate more. Compensation used to be based on firm and individual performance. Now it's based on the firm's performance, individual performance, and an individual's collaboration with others.

BIGGER CONTRACTS Accenture traditionally built tech systems for companies. Now it's competing for multibillion-dollar contracts to take over and manage the operations of its clients. Accenture has won several megadeals, including a \$10 billion contract to oversee the U.S.-VISIT immigration project for the Homeland Security Dept.

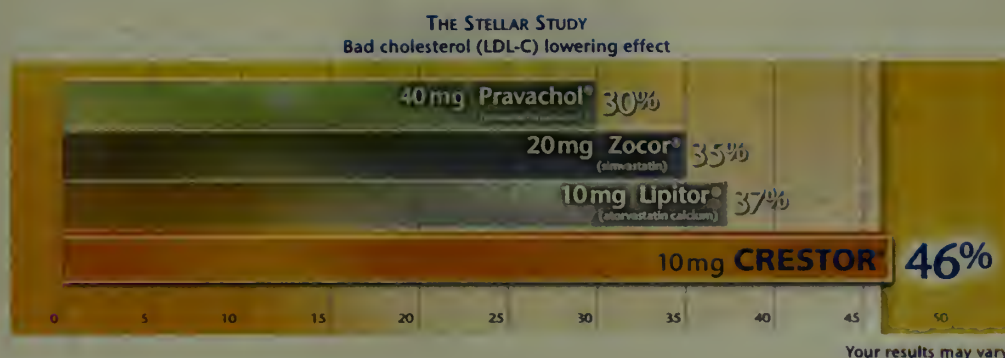
MINIMIZE RISK Well aware that taking on gigantic, multi-year contracts can be treacherous, Green is trying to cut the risk. He appointed a top exec to manage bids in a newly created job: Chief Quality & Risk Officer.

BusinessWeek online To read a Q&A with Bill Green, go to www.businessweek.com/magazine/extra.htm

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Important information: CRESTOR is prescribed along with diet for lowering cholesterol and is not for everyone, including people with liver disease, and women who are nursing, pregnant, or may become pregnant. Tell your doctor promptly if you experience unexplained muscle pain or weakness, as they may be a sign of serious side effects. Be sure to tell your doctor about other medications you are taking. Simple blood tests are needed to check for liver problems before and 12 weeks after start of therapy or change of dose, and periodically thereafter. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away. CRESTOR has not been shown to prevent heart disease or heart attacks. See adjacent page for additional important information.

*Source: Most commonly prescribed doses based on IMS (August 2003-July 2004).

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AstraZeneca

Please read this summary carefully and then ask your doctor about CRESTOR. No advertisement can provide all the information needed to determine if a drug is right for you. This advertisement does not take the place of careful discussions with your doctor. Only your doctor has the training to weigh the risks and benefits of a prescription drug.

BRIEF SUMMARY: For full prescribing information, see package insert.

INDICATIONS AND USAGE: CRESTOR is indicated 1. as an adjunct to diet to reduce elevated total-C, LDL-C, ApoB, non-HDL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable.

CONTRAINDICATIONS: CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation:** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULD BE ADMINISTERED TO WOMEN OF CHILDBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE AND HAVE BEEN INFORMED OF THE POTENTIAL HAZARDS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS:** **Liver Enzymes:** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN]) occurring on 0, 2, or 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter. Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINDICATIONS). **Myopathy/Rhabdomyolysis:** Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class. Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see ADVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses of up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses of up to 40 mg in clinical studies. Rare cases of rhabdomyolysis were seen with higher than recommended doses (80 mg) of rosuvastatin in clinical trials. Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (>65 years), hypothyroidism, and renal insufficiency. The incidence of myopathy increased at doses of rosuvastatin above the recommended dosage range. Consequently, 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see DOSAGE AND ADMINISTRATION), advanced age, and hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine (see CLINICAL PHARMACOLOGY, Drug Interactions, PRECAUTIONS, Drug Interactions, and DOSAGE AND ADMINISTRATION). The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (See DOSAGE AND ADMINISTRATION and PRECAUTIONS, Drug Interactions). 4. The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General). 5. Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, major surgery, trauma, severe metabolic, endocrine, and electrolyte disorders, or uncontrolled seizures). **PRECAUTIONS:** **General:** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment (CL_{CR} <30 mL/min/1.73 m²) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and DOSAGE AND ADMINISTRATION). Pharmacokinetic studies show an approximate 2-fold elevation in median exposure in Japanese subjects residing in Japan and in Chinese subjects residing in Singapore compared with Caucasians residing in North America and Europe. The contribution of environmental and genetic factors to the difference observed has not been determined. However, these increases should be considered when making rosuvastatin dosing decisions for patients of Japanese and Chinese ancestry (see WARNINGS, Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race). **Information for Patients:** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Drug Interactions). **Laboratory Tests:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients taking rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine laboratory tests. **Drug Interactions:** **Cyclosporine:** When rosuvastatin 10 mg was administered to cyclosporine-treated patients, rosuvastatin mean C_{max} and AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consid-

eration in the dosing of rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis, and DOSAGE AND ADMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumatin anti-coagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been documented, INR can be monitored at the intervals usually recommended for patients on coumatin anti-coagulants. If the dose of rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anti-coagulants. **Gemfibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemfibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean C_{max} and mean AUC of rosuvastatin (see DOSAGE AND ADMINISTRATION). **Endocrine Function:** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as testosterone, spironolactone, and cimetidine. **CNS Toxicity:** CNS vascular lesions, characterized by perivascular hemorrhages, edema, and mononuclear cell infiltration of perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallerian degeneration of retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/day based on AUC). Doses <30 mg/kg/day (systemic exposures <60 times the human exposure at 40 mg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility:** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence of uterine stromal polyps was significantly increased in females at 80 mg/kg/day at systemic exposure 20 times the human exposure at 40 mg/day based on AUC. Increased incidence of polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 30 mg/kg/day for one month, spermatid giant cells were seen. Spermatid giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolation of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class. **Pregnancy:** **Pregnancy Category X** (see CONTRAINDICATIONS). Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg/kg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose of 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised of the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 post-coitus results in decreased fetal body weight (female pups) and delayed ossification at the high dose (systemic exposures 10 times human exposure at 40 mg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning), decreased pup survival occurred in groups given 50 mg/kg/day, systemic exposures ≥ 12 times human exposure at 40 mg/day based on body surface area comparisons. In pregnant rabbits given oral gavage doses of 0.3, 1, 3 mg/kg/day from gestation day 6 to lactation day 18 (weaning), exposures equivalent to human exposure at 40 mg/day based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at ≤ 25 mg/kg/day or in rabbits ≤ 3 mg/kg/day (systemic exposures equivalent to human exposure at 40 mg/day based on AUC or body surface area comparison, respectively). **Nursing Mothers:** It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk at levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because of the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin taking into account the importance of the drug to the lactating woman. **Pediatric Use:** The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in a pediatric population is limited to 8 patients with homozygous FH. None of these patients was below 8 years of age. **Geriatric Use:** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency of adverse events and

types of adverse events were similar in patients above and below 65 years of age (see WARNINGS, Myopathy/Rhabdomyolysis). The efficacy of rosuvastatin in the geriatric population (>65 years of age) was comparable to the efficacy observed in the non-elderly population. **ADVERSE REACTIONS:** Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies of 10,275 patients, 3.7% were discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences:** Adverse experiences, regardless of causality assessment, reported in $\geq 2\%$ of patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1; discontinuations due to adverse events in these studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

Adverse event	Rosuvastatin N=744	Placebo N=382
Pharyngitis	9.0	7.6
Headache	5.5	5.0
Diarrhea	3.4	2.9
Dyspepsia	3.4	3.1
Nausea	3.4	3.1
Myalgia	2.8	1.3
Asthenia	2.7	2.6
Back pain	2.6	2.4
Flu syndrome	2.3	1.8
Urinary tract infection	2.3	1.6
Rhinitis	2.2	2.1
Sinusitis	2.0	1.8

In addition, the following adverse events were reported, regardless of causality assessment, in $\geq 1\%$ of 10,275 patients treated with rosuvastatin in clinical studies. The events in italics occurred in $\geq 2\%$ of these patients. **Body as a Whole:** Abdominal pain, accidental injury, chest pain, infection, pain, pelvic pain, and neck pain. **Cardiovascular System:** Hypertension, angina pectoris, vasodilatation, and palpitation. **Digestive System:** Constipation, gastroenteritis, vomiting, flatulence, peridontal abscess, and gastritis. **Endocrine:** Diabetes mellitus. **Hemic and Lymphatic System:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** Peripheral edema. **Musculoskeletal System:** Arthritis, arthralgia, and pathological fracture. **Nervous System:** Dizziness, insomnia, hypotonia, paresthesia, depression, anxiety, vertigo, and neuralgia. **Respiratory System:** Bronchitis, cough increased, dyspnea, pneumonia, and asthma. **Skin and Appendages:** Rash and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. (See PRECAUTIONS, Laboratory Tests.) Other abnormal laboratory values reported were elevated creatine phosphokinase, transaminases, hyperglycemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and thyroid function abnormalities. Other adverse events reported less frequently than 1% in the rosuvastatin clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, hypersensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous rash, urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, photosensitivity reaction, myopathy, and rhabdomyolysis. **OVERDOSAGE:** There is no specific treatment in the event of overdose. In the event of overdose, the patient should be treated symptomatically and supportive measures instituted as required. Hemodialysis does not significantly enhance clearance of rosuvastatin. **DOSAGE AND ADMINISTRATION:** The patient should be placed on a standard cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during treatment. CRESTOR can be administered as a single dose at any time of day, with or without food. **Hypercholesterolemia (Heterozygous Familial and Nonfamilial) and Mixed Dyslipidemia (Fredrickson Type IIa and IIb):** The dose range for CRESTOR is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to goal of therapy and response. The usual recommended starting dose of CRESTOR is 10 mg once daily. Initiation of therapy with 5 mg once daily may be considered for patients requiring less aggressive LDL-C reductions or who have predisposing factors for myopathy (see WARNINGS, Myopathy/Rhabdomyolysis). For patients with marked hypercholesterolemia (LDL-C > 190 mg/dL) and aggressive lipid targets, a 20-mg starting dose may be considered. The 40-mg dose of CRESTOR should be reserved for those patients who have not achieved goal LDL-C at 20 mg (see WARNINGS, Myopathy/Rhabdomyolysis). After initiation and/or upon titration of CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted accordingly. **Homozygous Familial Hypercholesterolemia:** The recommended starting dose of CRESTOR is 20 mg once daily in patients with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should be used in these patients as an adjunct to other lipid-lowering treatments (e.g., LDL apheresis) or if such treatments are unavailable. Response to therapy should be estimated from pre-apheresis LDL-C levels. **Dosage in Patients Taking Cyclosporine:** In patients taking cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Concomitant Lipid-Lowering Therapy:** The effect of CRESTOR on LDL-C and total-C may be enhanced when used in combination with a bile acid binding resin. If CRESTOR is used in combination with gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WARNINGS, Myopathy/Rhabdomyolysis, and PRECAUTIONS, Drug Interactions). **Dosage in Patients With Renal Insufficiency:** No modification of dosage is necessary for patients with mild to moderate renal insufficiency. For patients with severe renal impairment (CL_{CR} <30 mL/min/1.73 m²) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily and not to exceed 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Special Populations, Renal Insufficiency).

NOTE: This summary provides important information about CRESTOR. For more information, please ask your doctor or health care professional about the full Prescribing Information and discuss it with them.

Rx only

Reference: IMS National Prescription Audit (August 2004).

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COMMENTARY

BY WILLIAM C. SYMONDS

Should Public Universities Behave Like Private Colleges?

They're hiking tuition and becoming more elitist—ducking a key social role

EVER SINCE THOMAS JEFFERSON founded the University of Virginia in 1825, it has been a leader among the nation's public universities. But in recent years, Richmond's contribution to one of its best-known institutions has been steadily shrinking. Today, the state provides just 8% of UVA's \$1.7 billion annual operating budget, down from 28% two decades ago.

No wonder UVA—along with the College of William & Mary and Virginia Polytechnic Institute—wants to cut some of the strings that bind it to the state. Virginia's three flagship universities have asked the General Assembly to make them “chartered” universities. If Richmond agrees, they would get more freedom to set tuition and run themselves, making them more like Harvard, Princeton, or other private colleges.

America's public institutions still educate some 80% of the nation's 14 million undergraduate students. But increasingly, the crown jewels in this system, the state flagship universities such as UVA, Pennsylvania State, and the University of Colorado, are aiming to break out of the mold that traditionally has differentiated them from private universities.

To date, no major public university has been fully privatized. But as the states foot a smaller share of their budgets, the flagships have become more dependent on tuition and other sources of funds. They may still be publicly owned, but increasingly they're privately financed. So a number of the flagships are seeking more freedom from state control (table, page 100). In July, University of Colorado President Elizabeth Hoffman won “enterprise status” for her school, which means it's no longer governed by the same rules as state agencies. Miami University of Ohio

recently became the first major public campus to adopt the high-price, high-financial-aid tuition model used by elite private colleges. That means all students across the board are now charged \$19,642, although Ohio residents receive scholarships of at least \$10,000. “We are becoming more like our private counterparts,” says Penn State President Graham B. Spanier.

This is a powerful yet troubling trend. On the one hand, the flagships are being forced to rely more on fund-raising, research grants, and other private or nonstate money. Given this reality, it makes sense to free them up from state rules that could impede their ability to become efficient and competitive. Such moves could help to insulate them from meddling politicians, as well.

Squeezing the Poor

AT THE SAME TIME, creeping privatization accelerates a broader movement by the top 100 or so flagships to hike their tuitions at a double-digit rate. The result is that a public good designed to give all Americans access to higher ed is turning into something more like a private one, open primarily to those whose families can afford it. Already, the student body at some flagship campuses is more affluent than at elite private schools: At Ohio's Miami, for one, the median family income tops \$100,000 a year.

Moreover, as flagships break free, support could erode for less prestigious state schools that remain more dependent on public funds. Privatization “will accelerate the social stratification of higher education, in which the elite [public colleges] are primarily filled with kids from privileged backgrounds, and the kids from poorer families are concentrated in less prestigious schools,” says David W. Brenehan, dean of the Curry School of Education at UVA. At the nation's 146 most selective colleges—including the top flagships—just 3% of entering freshman come from the bottom socioeconomic quarter, while a staggering 74% come from the top quarter.

The flagships say they have lit-



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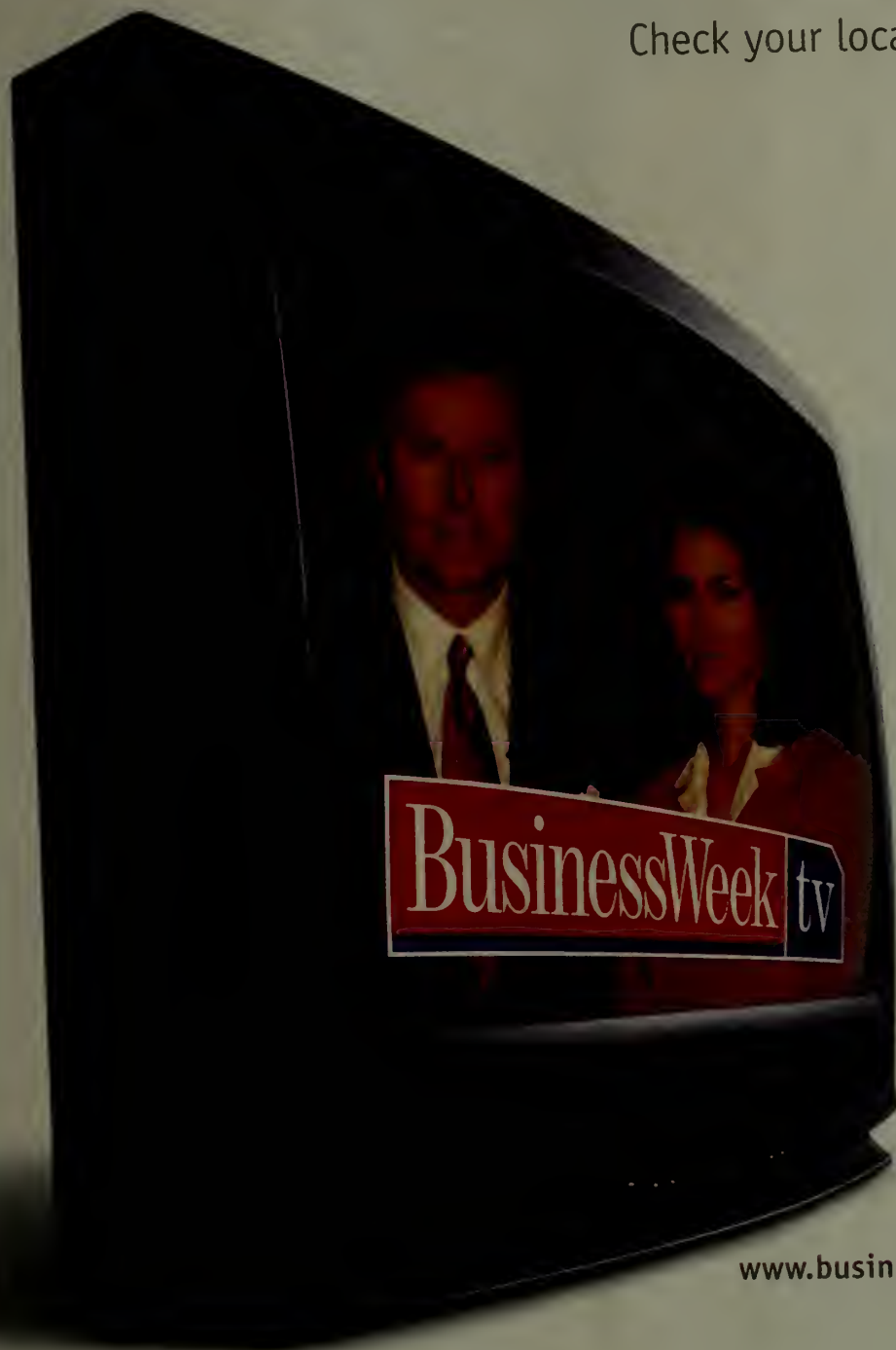
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Social Issues Education

the choice. Although state and local governments still cover 64% of the cost of public higher education, other sources fund a much larger share at most elite public colleges. Today, Ohio provides only 15% of Miami's total revenues. At Penn State, only 12% of the budget comes from state funds, says Spanier. At Colorado, Denver kicks in just 9%.

To raise funds elsewhere, most look to students. This year, four-year public colleges raised tuition by nearly 11%, more than three times the overall rate of inflation, to an average of \$5,132 for in-state students, according to the College Board. Over the past decade, tuition has climbed 90%. With room and board, the annual tab at public colleges averages more than \$11,000. Although those costs are less than the \$27,500 at private colleges, the hikes reflect a view that flagships should seek funds from those willing—and able—to pay. Take UVA, where the state froze tuition in four of the past eight years. If it's granted charter status, UVA could raise in-state tuition to \$10,200 over the next five years, up from \$6,600 now, says UVA Chief Operating Officer Leonard W. Sandridge. UVA, however, is launching a more generous financial-aid program.

The fear is that the flagships will use their market power to price poor and middle-class students out of their classrooms. Penn State already charges in-state students more than \$10,000 a year, although it also provides significant financial aid to poorer students. A more typical approach is to hit up out-of-state students. UVA charges nonresidents more than three

times as much as Virginians. "In effect, they're paying 150% of the cost of their education," concedes Sandridge. At Colorado, whose Boulder campus is a magnet for affluent nonresidents, out-of-state students generate 72% of total tuition revenue even though they're only 30% of the student body.

The danger is that ever-rising tuitions will exacerbate inequities in higher education. Because out-of-state students tend to be affluent, public flagships that rely on them already are serving fewer low-income students. Indeed, less than 9% of students at UVA and William & Mary received federal Pell Grants for poor students in 2000, vs. 10% at Yale University and 16% at Amherst College, according to a study by the Century Foundation, a New York research group. Already, "many flagships are not serving their traditional role of providing broad access to the brightest from all economic backgrounds," says Century senior fellow Richard D. Kahlenberg.

A growing source of income: wealthy, out-of-state students

Sliding Scale

ONE SOLUTION IS FOR flagships to adopt a variable pricing model similar to the one that's used at private colleges. Miami recently began offering larger scholarships to Ohio students from needier families while charging more to affluent ones. The gap is only \$1,200 a year, but President James C. Garland intends to widen it sharply. Already, he says, the university has seen a large increase in applications from moderate-income students.

North Dakota has found a more comprehensive solution. Historically, the legislature micromanaged the 43,000-student university system. But in 2001, it scrapped most controls, giving colleges lump sums that they could spend as they saw fit, plus complete pricing flexibility. In return, the universities agreed to meet accountability measures that include graduation rates, student retention, and economic benefits.

The result has been far more entrepreneurial behavior. Distance learning has increased, and research work has doubled at the two flagship schools, the University of North Dakota and North Dakota State. There's also a new emphasis on recruiting out-of-state students to offset an expected drop in North Dakota high school grads because of the declining population. "The university system is now viewed as a primary economic engine for the state," says University System Chancellor Robert Potts.

Still, North Dakota is an exception. In other states, the flagships often try to solve their problems with little regard for the rest of the state system. "Each of these decisions is being made piecemeal," worries Stanley O. Ikenberry, the former president of the University of Illinois. "What's absent is any national dialogue about what these changes will mean for America."

What's more, public universities seem reluctant to give up their public funding altogether. Earlier this year, South Carolina Governor Mark Sanford offered his state's universities the chance to become fully private, meaning they actually would own their campuses. But because they would also have had to give up all direct state support, none stepped forward.

Public universities have played a fundamental role in American society, from spurring technology to helping create and expand the country's middle class. But without better planning, the move to keep them competitive could widen the already growing class divide in higher ed. ■

**BREAKING
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Colorado's
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Revolt of the Flagships

Some elite state universities want the ability to act more like private colleges:

COLORADO With state funds now providing just 9% of the University of Colorado's budget, the legislature in July granted it "enterprise status," giving it more freedom to raise tuition and manage itself.

NORTH DAKOTA Has given its 11 state universities and colleges far more flexibility to set tuition and run their affairs, in exchange for a new accountability system that sets goals for university performance.

OHIO This fall, Miami University of Ohio began charging all students out-of-state tuition of \$19,642. But Ohio residents receive scholarships of at least \$10,000 apiece.

VIRGINIA The top three public schools—the University of Virginia, William & Mary, and Virginia Tech—want to become "chartered universities," which would free them from many state regulations.

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Tour Builder

How Nationwide
CEO Jerry Jurgensen
has driven his
company into the
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A Golf League

» Corporate golf leagues can be a great way to foster friendships and teamwork among employees. Here's how to organize yours

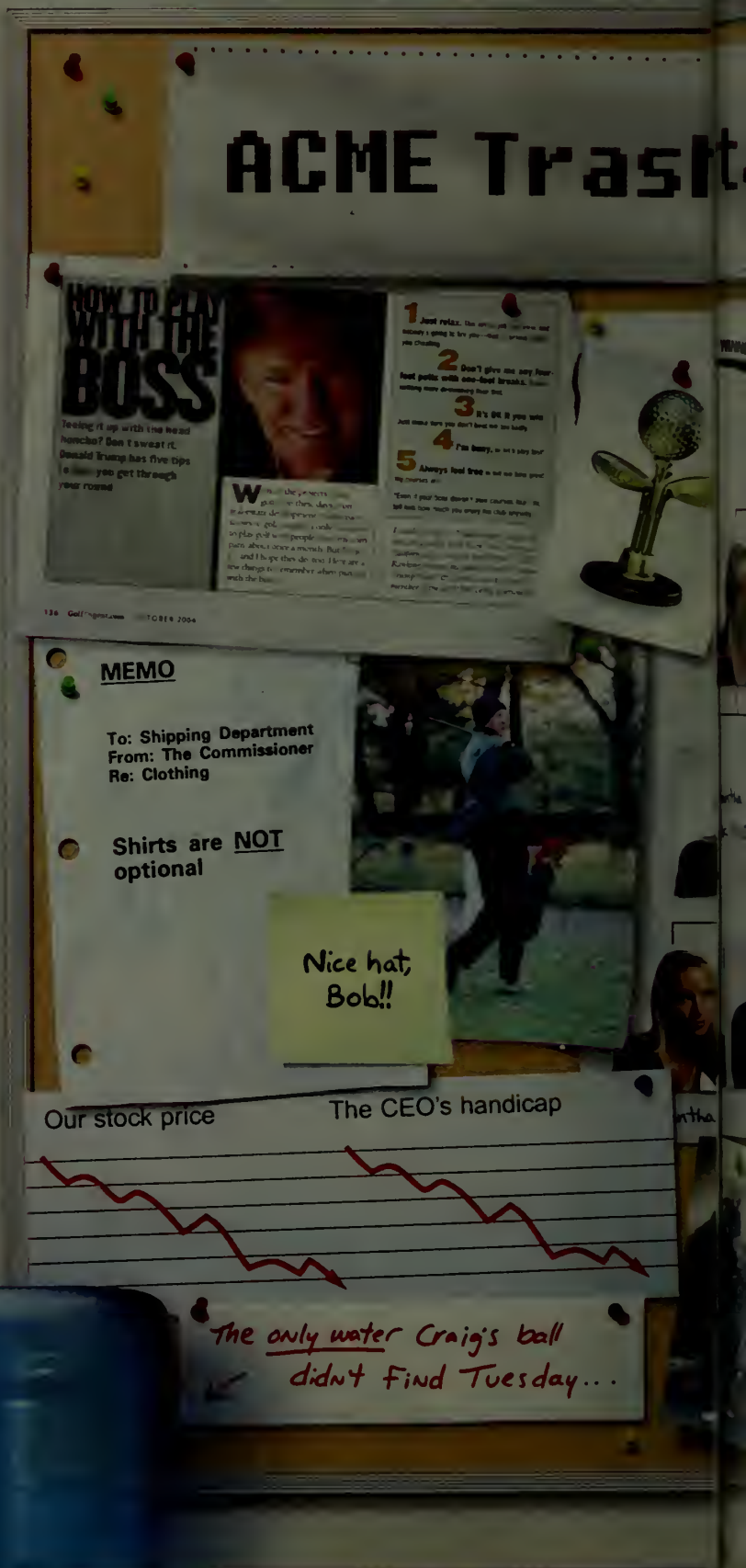
By Peter McCleery • Illustration by Chris O'Riley

WHEN HE FIRST JOINED MGIC as marketing manager 23 years ago, Curt Culver, *Golf Digest*'s top-ranked golfing CEO with a 2.4 Handicap Index, spent time in league play mingling with—and undoubtedly impressing—his superiors with his acumen on the course. “Where else would I have had such an opportunity?” says Culver, now president and CEO of the mortgage-insurance firm.

Culver has carried on the tradition of the corporate golf league at MGIC, where employees relish the occasional matchup with the Big Boss. Although the demands of his job have limited him to substitute duty in the MGIC league, Culver's participation and support gives the league an added appeal. Employees who were paired with Culver in the past “talked about it for weeks,” according to Jack Long, one of the league's former administrators. “Curt believes good golf transfers over to your work in terms of the commitment and concentration it takes.”

MGIC has encouraged participation among all levels of golfers, including beginners, to escape the perception that golf is an elite activity. The company's Milwaukee office (with a workforce of 600) has a 16-team league with at least four players each.

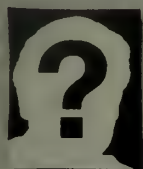
“It's just such a positive experience to be out there on a golf course with fellow employees, sharing the good shots and the bad shots and walking around together,” Long says. “For those nine holes, you're on the same team. That doesn't al-



of Their Own

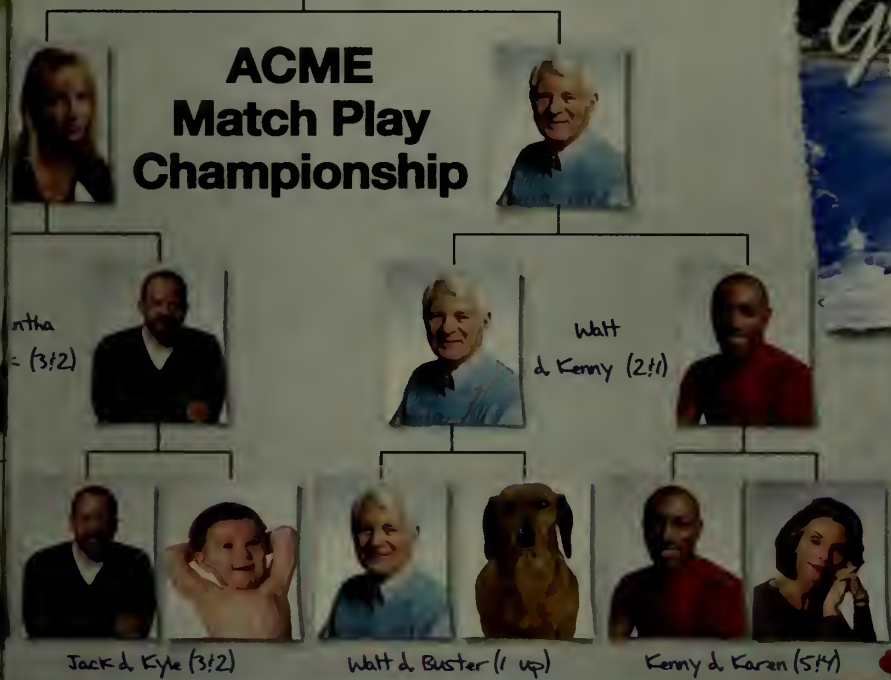
Talking Bulletin Board

WINNER GETS THIS...



...AND THIS!!

ACME Match Play Championship



EXCUSE OF THE WEEK

"I had the wrong laces on my shoes."

—John Donahue, accounting



To Hank
 Date 10/3 Hour 2:30
While You Were
 From Your Golf Trust
 Re: Your Banana B
 Phone 9/11

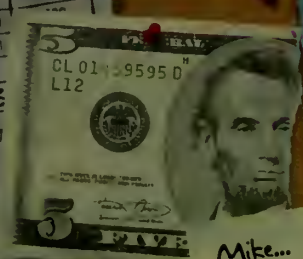
TELEPHONED		PLEASE CALL
RETURNED CALL		WILL CALL AG
WANTS TO SEE YOU		URGENT

Message:
CALL ME ASAP!!

Complaining about sandbagging?
 Call someone who cares!

HOLE	1	2	3	4	5	6	7	8	9	OUT
YARDS	435	519	198	130	455	356	411	482	220	
METERS	396	475	181	393	416	326	376	441	201	
PAR	4	5	3	4	4	4	4	4	3	
Mike	4	6	3	4	5	3	5	5	3	
Sam	6	6	5	7	5	4	6	6	5	
Ted	5	5	3	5	4	4	6	7		
Bob	6	5	4	6	7	7	5	5		

The most undeserving champion since the '72 Russian basketball team.



Mike... You'll get the other half when you post the rest of your scores.

Steve thinks he's Tiger Woods



ways happen in corporate America.” Culver says the MGIC league “enables our employees to meet more of their co-workers than they might otherwise do, and to learn that they’re good people.”

Organizers of corporate golf leagues say that inclusiveness and the emphasis on bonding, instead of the competitive aspect, is a key to success. The best leagues foster friendships, teamwork, and camaraderie, build relationships within companies, and offer an after-work social and semicompetitive outlet.

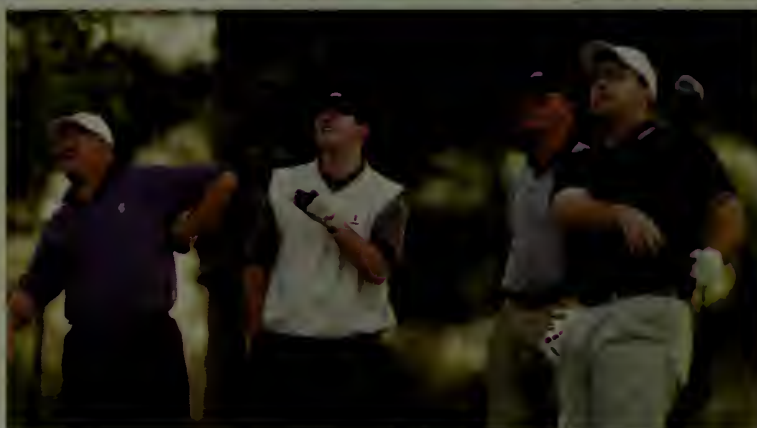
In most cases league participants play only against employees within their company, but some compete against other firms. Golf leagues are deeply embedded in hundreds of corporate cultures, from lumberyards to telecommunications companies. Sprint has golf leagues, for example, that date back 25 years.

Public golf courses, which typically have men’s and women’s leagues of their own, enjoy the additional revenue corporate leagues can provide during off-peak hours, usually weekdays after 4 p.m. The head professional at one of the courses that hosts Sprint, Jeff Moore of St. Andrews Golf Club in Overland Park, Kan., says corporate leagues account for more than 10 percent of the 64,000 annual rounds played.

Leagues tend to engender a healthy spirit within the corporate culture and reflect the personalities of those who participate and administer them. In most leagues, employees play nine holes after work.



» Leagues tend to engender a healthy spirit within the corporate culture and offer employees a social outlet.



EMPLOYEE PARTICIPANTS IN THE HORMEL FOODS LEAGUE ENJOY THE GOOD-NATURED RIBBING THAT RESULTS FROM TEAM PLAY.

They also get an unofficial but widely enjoyed fringe benefit: the opportunity to exit early from the office to make it to the first tee. A longtime player at Bausch & Lomb Pharmaceuticals in Tampa described it as “our afternoon ritual, bugging out” an hour or so before Monday golf’s 4:30 p.m. official tee time.

Golf Digest editors participate in an annual match-play tournament not known so much for its operational efficiency as for the ribbing given and taken when editors knock each other out.

Leagues take various forms, but most follow a similar blueprint: Team and individual net matches are played simultaneously with in-house handicaps monitored by a league administrator, sometimes known as “the commissioner.” Individual and team standings are kept, and results are posted and circulated, usually through the company Internet site or e-mail system, culminating in a year-end trophy and bragging rights.

Some companies and their golf-obsessed employees take the notion to extremes

with complicated formats: An employee at an engineering company complained to us that no one could comprehend his league’s format except the engineer who runs it. Computer software programs are available to help set up your league and track handicaps and results. NetGolf.com, for example, has had more than 950 clients sign up for its service in the past three years. Tom Schumacher, administrator of the Carter-Jones Lumber League in Akron, Ohio, says a computer program has cut his weekly time inputting scores and issuing updates by more than 50 percent.

One thriving league in Minnesota has a popular

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"Trash Talk" bulletin board where participants are publicly tarred and feathered, all in good fun. "If you're trashed you know you're loved," says Jerry Haas, plant controller and administrator of the company league for Hormel Foods in Austin. "If you're ignored, you may be a horse's patoot." His regular bulletins begin: "Some days you struggle to find trash and other days are simply a lay-up." We'll take his word for it.

A survey of league organizers and participants revealed several important do's and don'ts, procedures proven to work and pitfalls to avoid. In relative order of importance, they are:

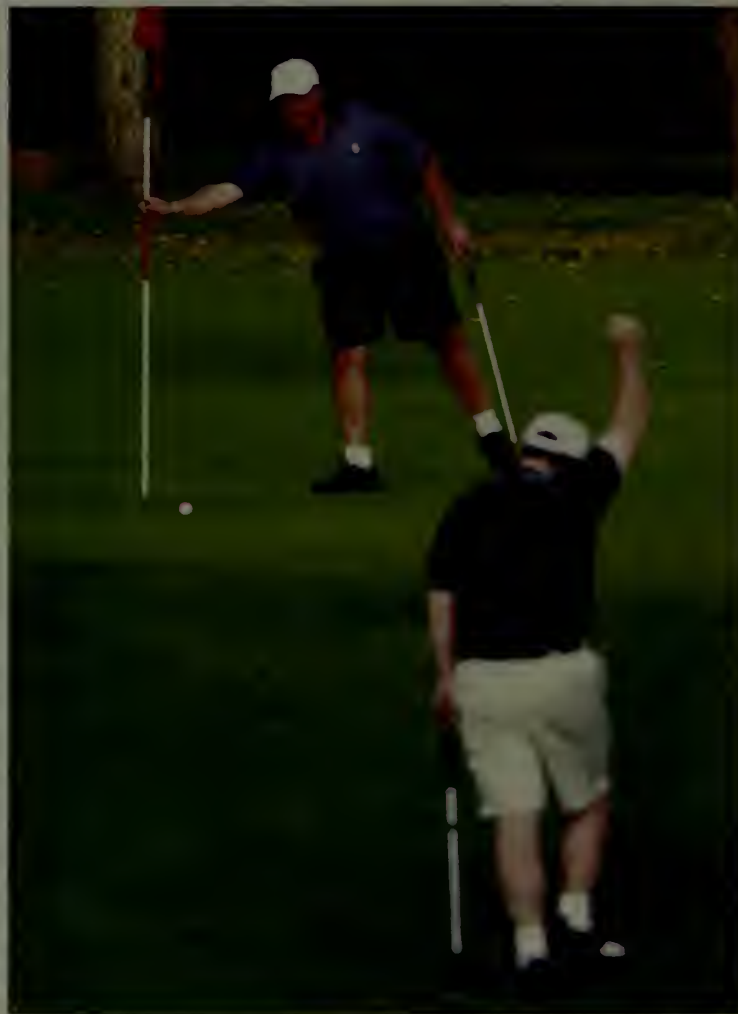
1. A formal structure. Leagues require an organizational structure and organizers to keep them on track. At Kelly Services, the temporary-employee firm in Troy, Mich., official bylaws require three elected officers to oversee the 28-player league, and an annual "broadcast message" goes out each winter to encourage diverse participation. There is an open application period to make sure the league is "as democratic as possible," according to president Ed Perez. When problems arise about issues such as absenteeism, slow play, or handicaps—three recurring problems among leagues—Perez says he will speak to the miscreant, then send out a gentle broadcast message reminding all participants to, say, pick up the pace. A league fee of \$25 to \$50 generally covers the cost for prizes and administration, and green fees usually run about \$20 weekly unless you take a cart. Many companies subsidize the leagues by 25 percent or more.

MOST LEAGUES TAKE THE FORM OF NINE HOLES AFTER WORK, WITH AN EARLY EXIT FROM THE OFFICE A POPULAR FRINGE BENEFIT.

An enthusiastic administrator is the point person for making a company league work. But he or she can't always go it alone, especially when problems arise. To help deal with grievances, small committees ensure that no single employee is constantly pitted against others. At Sprint, league administrator Fred Bleedorn is joined by two others on the grievance committee. "You don't want to create hard feelings," he says. "This way you get different viewpoints and three people listening to and ruling on any problems that crop up."

2. Handicapping. This is a thorny issue for all competitive leagues, especially ones designed to attract beginners. Hormel, with its league based at a private country club, requires all league participants to carry a USGA handicap. MGIC allows players to participate twice without a handicap, then begins tracking and assigning handicaps internally. Kelly Services' golf league purchased a software system that provides a handicap with players' four best of their last six scores. Some league offices must deal with sandbaggers and "vanity" handicappers who don't play anywhere near their posted number. If you cannot get a USGA Handicap Index, go to golfdigest.com/handicap to register for a Golf Digest Handicap. In addition to providing a fast way to establish a handicap, the free service allows you to record data from your rounds, such as fairways hit and number of putts.

3. Timing. One of the allures of league play is the early escape from work, a semi-legit excuse to get out of the office on company



» Companies should encourage participation among all levels of golfers, including beginners.



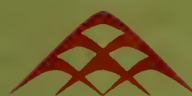


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time. "We've learned by now not to schedule meetings after 4 p.m. on Tuesdays," says Julie Craven, Hormel's director of corporate communications. But once on the course, the time that league play requires quickly becomes a sore point when nine-hole rounds exceed 2½ hours. (One participant contacted us about his plans to discreetly drop his laggardly partner, then recanted after his mate suddenly picked up the pace.) With individual and team matches often in play at the same time, players tend to hole out everything. Try to avoid the tendency to turn casual Tuesday afternoons into U.S. Open Sundays. Leave a little time for the cocktail hour before it turns dark. Monday-morning quarterbacking is fine, but morning hangovers are not recommended.

4. Communication. Make sure employees across the company's divisions and departments know about the league's existence. Not everyone is part of the e-mail culture. Royal Precision, a shaftmaker in Torrington, Conn., with 120 employees, has a nice league going, but it involves just 12 players. "I've had people who work in the factory come up to me and say, 'I didn't know we had a league,'" says Randy Pollock, Royal Precision's vice-president of quality and engineering. "We're going to do more publicity next year to make sure everyone knows."

5. Building and sustaining interest. Because most leagues run concurrent with the golf season from May into September, it can become a lengthy commitment. That's why substitutes are needed to fill in for regulars who are out of town or otherwise unavailable. Some leagues allow nonemployees to serve as substitutes. Teams and individuals who are faring poorly tend to lose interest as the season progresses. To counteract this, Kelly Services splits its season in two with a midseason special match-play event followed by a clean slate when league play resumes. "If you're near the bottom in the points standings by mid-July there's no way to catch up," says Perez. "This way we start fresh at midseason with everyone even."

6. Avoid sexism/elitism. Leagues dominated by male players inevitably tend to be regarded as elitist or sexist. Women need to be encouraged to play so the league doesn't become a "boys night out."

» An enthusiastic administrator is the point person for making a company league work.

To: Hank ☐ AM ☒ PM
 Date: 10/3 Hour: 2:30
While You Were Out
 From: Your Golf Instructor
 Re: Your Banana Ball
 Phone: 911

TELEPHONED	☐	PLEASE CALL	☒
RETURNED CALL	☐	WILL CALL AGAIN	☒
WANTS TO SEE YOU	☐	URGENT	☒

Message: _____
CALL ME ASAP!!

Leigh Lassiter-Counts, who works for the University of Texas Medical Branch in Galveston Island, says her 21-handicap (for nine holes) invokes occasional sneers when she wins matches. "I'll get out there and hit one good shot and they say, 'Oh, you're a 21, yeah, right.' Sometimes the guys get a little irked if they get beat by a girl," she says.

Chauvinistic ribbing aside, Lassiter-Counts' experience embodies the positive values of a company golf league. When she arrived in 2003 she knew no one among the 13,000 employees. "It was me and 13,000 strangers." The league gave her something to do and

a way to make friends, even among some of the chauvinists. "It was nice to have people to do things with and not always go home and have dinner by myself," she says. Through the league, part of the university's "Commit to Fit" initiative, she has rekindled her enthusiasm for the game and has had the chance to meet and interact with "people that I never would have met. It's fun to see folks in golf clothes, then in work clothes, or sometimes the other way around."

Leagues can thrive in companies of many sizes and structures. Perhaps the leader in leagues is Nationwide, the insurance company whose CEO, Jerry Jurgensen, ranked second in *Golf Digest's* CEO listing (page GD12), 0.1 stroke behind Culver. Externally, Nationwide is the umbrella sponsor for the PGA Tour's secondary circuit; internally it has 22

golf leagues inhabited by hundreds of the 10,000 employees at its Columbus, Ohio, headquarters. The nine-hole, after-work leagues play at staggered starts depending on availability at various public courses in the area, with various formats in each league buttressed by a large roster of substitutes. The midsummer Nationwide Open has a field of 144 players. Employees pay 70 percent of the fees, with Nationwide kicking in a 30 percent subsidy. "It's an opportunity to network across the company and for us to share a little down time together," says Jackie Sells, associate program supervisor who oversees the league activity. "It also supports one of our company values, which is, we have fun."

Sounds good to us. ■



Harold manages growth portfolios. Phil manages value portfolios.
They only meet at the watercooler.

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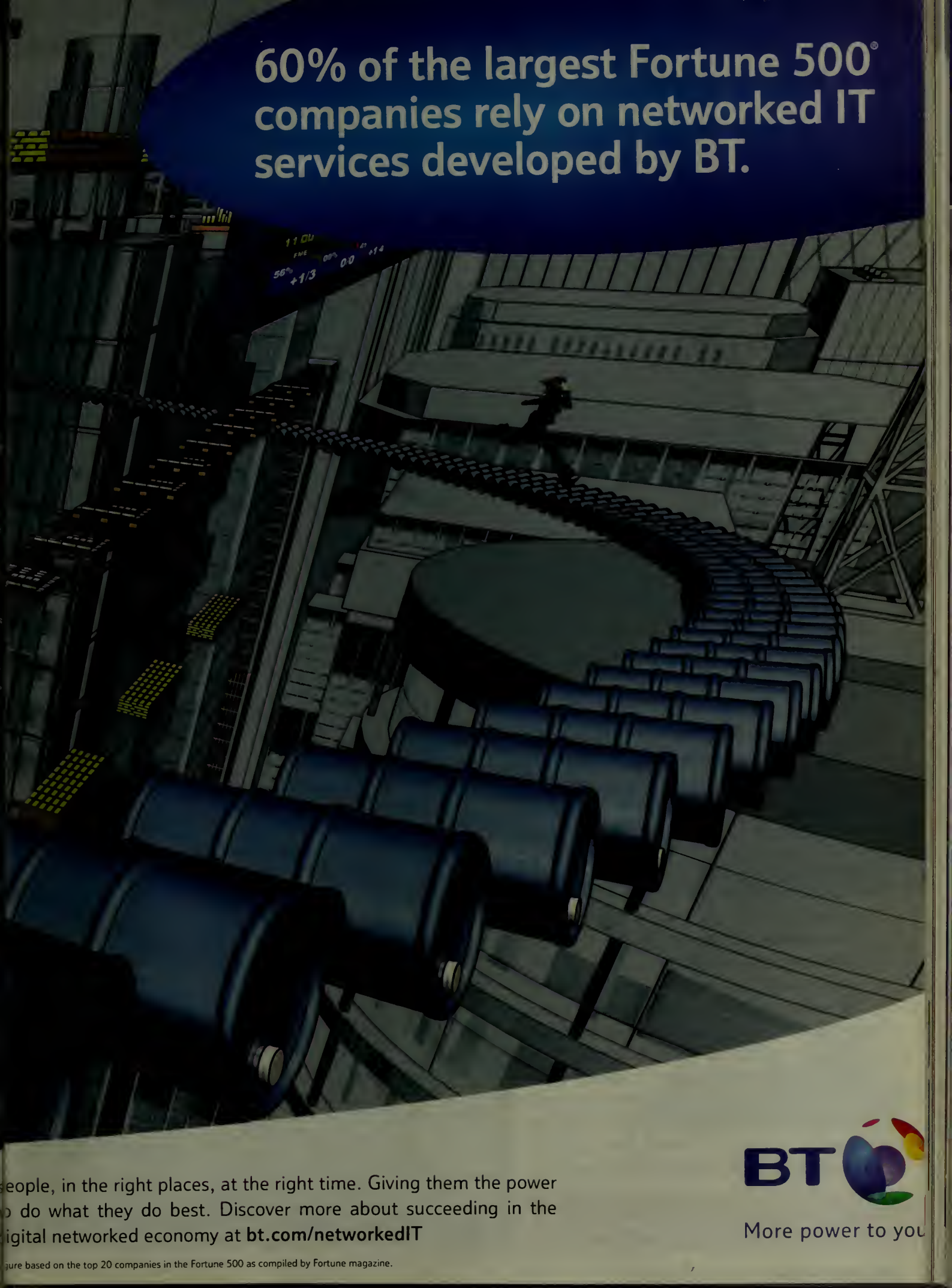
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Figure based on the top 20 companies in the Fortune 500 as compiled by Fortune magazine.



More power to you

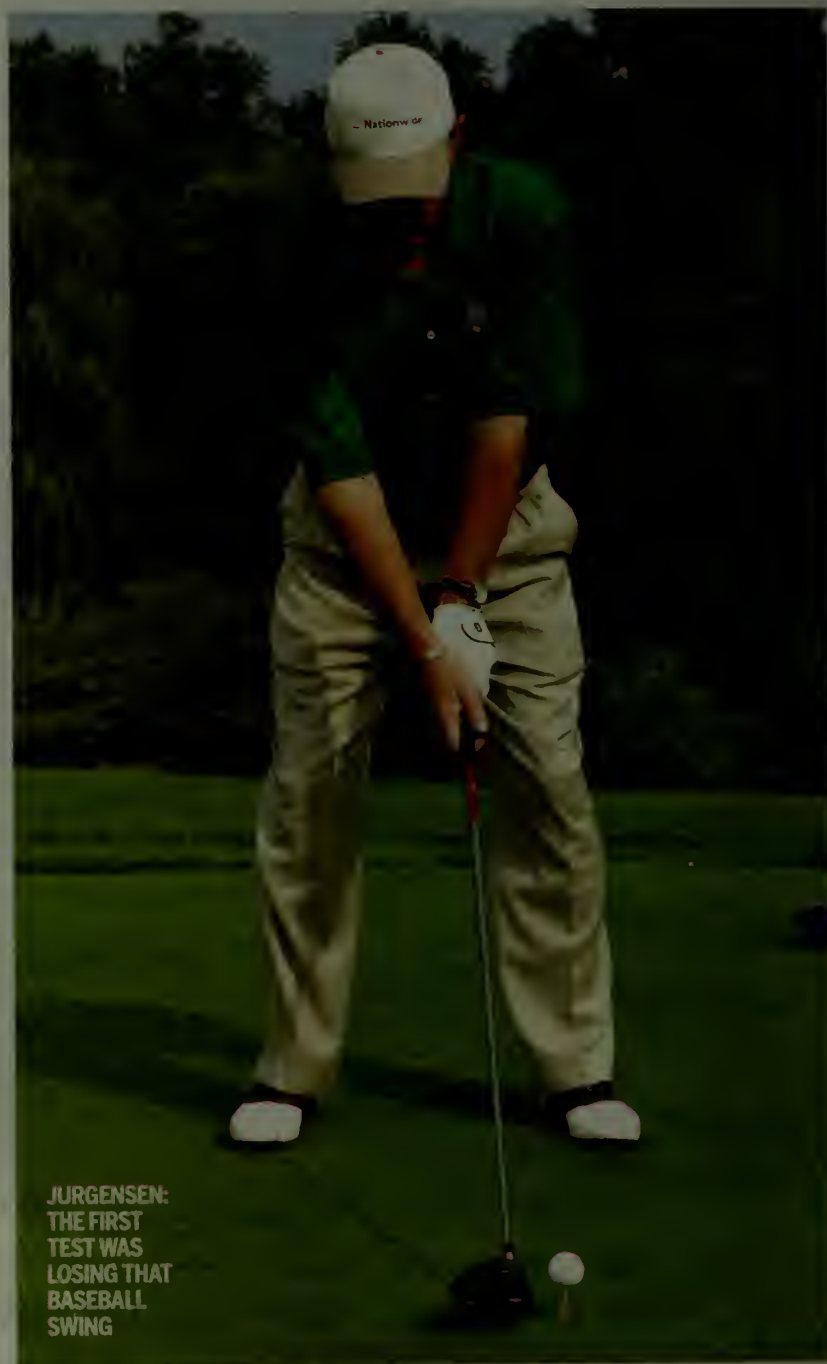
A Round with Jerry Jurgensen

» The sponsor of the PGA's developmental tour shows off his game at Muirfield Village
By Dean Foust

WHEN CEOS OF MAJOR companies set out to sponsor a pro golf event, most hitch their wagon to the PGA Tour—allowing them to bask in the aura of superstars such as Tiger Woods, Phil Mickelson, and Ernie Els. Not Jerry Jurgensen. Two years ago, the CEO of Nationwide, based in Columbus, Ohio, signed a five-year, \$50 million deal to succeed Buy.com as the umbrella sponsor of the PGA's developmental tour, where aspiring pros like Ryuji Imada and Bubba Watson toil in hopes of earning a promotion to the big leagues.

There was method to Jurgensen's underdog approach. An ardent golfer who counts PGA Tour pros Loren Roberts and Kirk Triplett as close friends, Jurgensen sensed that with the talent pool deepening, the developmental tour—now known as the Nationwide Tour—was gaining in popularity. “I got the idea in my head that the PGA Tour was already at 100 percent capacity—they can’t add any more players or tournaments—and this [developmental] tour was starting to take off,” he says. “We had the chance to become part of the vocabulary of a sport, rather than just the sponsor of a tournament.”

So far, Jurgensen's hunch appears to be paying dividends for the insurance giant he joined four years ago: Its tour generated 630 million media im-



JURGENSEN:
THE FIRST
TEST WAS
LOSING THAT
BASEBALL
SWING

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OUT SOFTBALL



pressions—the number of distinct times the Nationwide Tour was viewed on TV or in print—through July of this year, a 30% increase over the same period in 2003. At the same time, Jurgensen appreciates the gratitude of the young tour players, many of whom readily agree to play rounds with Nationwide employees and their clients before the tournaments. “I wrote a congratulatory letter to everyone who won last year, and every single one either phoned or wrote me back to say thanks for allowing them to chase their dreams,” he says.

Indeed, even as Jurgensen has agreed to walk 18 on a muggy August morning in Dublin, Ohio, with a guest at Muirfield Village Golf Club—site of Jack Nicklaus’ annual Memorial Tournament and the first course Jurgensen played after moving to Columbus four years ago—he can’t stop talking about the Nationwide Tour. While Buy.com had little involvement with the tour beyond writing the sponsorship check, Jurgensen’s staff has taken a hands-on role, down to helping pick the playing

venues to ensure that the tour expands into markets that are important to Nationwide. Jurgensen himself plays in one pro-am event on the Nationwide Tour each year, and last year played in the AT&T Pebble Beach National Pro-Am with Zach Johnson, the Nationwide Tour’s leading money-winner in 2003.

The 53-year-old executive took up golf in his late 30s. Prior to that—before his knees began to give out—baseball was his game: He pitched on his college team at Regis University in Denver, then later played slow-pitch softball while a banker for Northwest Corp. His first golf teacher was Paul Purtzer, a Minneapolis club pro whose brother Tom is a well-known PGA Tour player. “He had a baseball swing that we had to correct,” recalls Purtzer. “But he was an extremely quick learner.”

Indeed, under Purtzer, Jurgensen slashed his handicap from 18 to 9 in the first year alone. He’s now down to a mere 2.5, earning him the No. 2 spot on *Golf Digest*’s 2004 rankings of the best CEO golfers. One of his favorite playing partners is his wife, Patty, a 19-handicapper in her own right, as well as his two grown children whenever they’re in town visiting.

His passion for golf extends to equipment: He admits to owning a couple hundred clubs that he keeps at his houses in Columbus and Scottsdale, Ariz. “I’m always prowling the used-club bins at golf shops,” he says. Then he stops and grins: “You know, if you print that, I’ll get in trouble with my wife, because she has never stopped and counted.” On this particular morning, Jurgensen is playing with a TaylorMade r7 quad driver, Titleist 704.CB blade irons, and Sonartec NP-99 fairway woods.

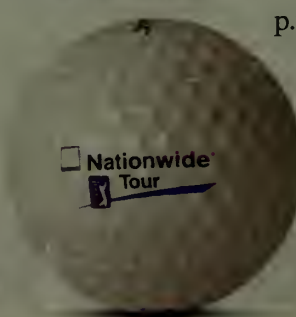
Backyard Putting

IN OTHER YEARS, Jurgensen routinely played as many as 100 rounds annually. Given the demands of his current job, though, he has recorded just 40 rounds this year through late August, mostly weekends and partial rounds after work. (Thanks to the fact that Columbus sits at the far western side of the Eastern time zone, Jurgensen can play until after 9 p.m. during the summers.) To keep his short

game tuned, he installed an artificial putting green in his backyard in Columbus. (He was so impressed by the green that he took a small stake in the company that makes it, TourTurf Holding LLC, based in Ponte Vedra Beach, Fla.)

Jurgensen couldn’t have picked a

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tougher day to tackle Muirfield Village, which a friend who's a member allowed him to play as an unaccompanied guest. Heavy rains earlier in the week, coupled with recent aerification, mean the course is playing considerably longer than the 7,265 yards listed as the distance from the back tees that Jurgensen chooses to use.

On his opening tee shot, he displays a long, fluid swing, with a prolonged pause at the top. He crushes the drive about 290 yards but it drifts into a clump of trees bordering the left side of the fairway. (As I soon discover, most of his drives routinely carry 280 yards.) Yet for such a brute off the tee, he demonstrates a surprisingly soft touch around the greens, which he attributes to recent lessons with Stan Uley, the short-game guru to many tour pros. After threading his second shot neatly through an opening in the trees and onto the green some 160 yards away, he two-putts to save a par on the first hole.

He flirts with trouble again on No. 3, which he warns is one of the trickiest holes on the course, mainly because of a devilish creek that meanders along the fairway and crosses in front of the green. Jurgensen pushes his drive off to the light rough on the right, then dunks his second shot into the creek. He takes a drop, pitches onto the green, and with two putts, walks off with a double bogey. "See what I told you?" he says as we saunter to the fourth tee.

Tin Cup Kid

JURGENSEN QUICKLY hits his stride, playing the next five holes at just one over par, thanks in part to a birdie on No. 7. On the ninth hole, a 407-yard par 4, he plays his tee shot safely into the fairway but lands his approach shot in the small pond fronting the green. Agitated, he fishes a ball out of his pocket and plops it at his feet. When I gently remind him that he's entitled to play his next shot much closer to the hole—at the edge of the pond, to be exact—he declines. "Nah," he says, "I'm going to do this just like Tin Cup"—a reference to the Kevin Costner movie character who stubbornly drops shot after shot into a pond on the last hole of the

U.S. Open. Jurgensen's next shot not only carries the pond but the green as well. With a chip and a putt, he cards another double bogey for a 41 on the front nine.

After a bogey on the 10th hole, Jurgensen plays the next six holes at two over par. The key: a pair of deft chip shots on Nos. 12 and 15 that let him save par on both holes. Jurgensen salvages a bogey on

the 17th with a beautiful bunker shot that stops dead a couple of feet from the hole. But trouble raises its head again on the par-4 18th when he hits his drive right into one of the bunkers that Nicklaus added in recent years, about 280 yards from the back tee. Jurgensen's bunker shot catches the front lip and comes to rest only a few yards away in the heavy rough. His third shot falls short of the green and into another bunker. All is not lost—because he steps up and hits one of his best shots of the day, a sand shot that nestles to within two feet of the pin for a tap-in 5. Given that the back "Memorial" tees carry a course rating of 76.3 and a slope rating of 149, his final score of 82 registers as a solid outing that won't dent his handicap. Although Jurgensen has just acquitted himself well on one of the PGA Tour's

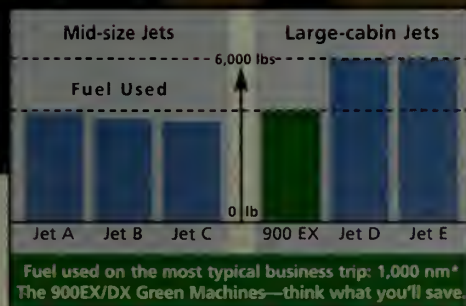
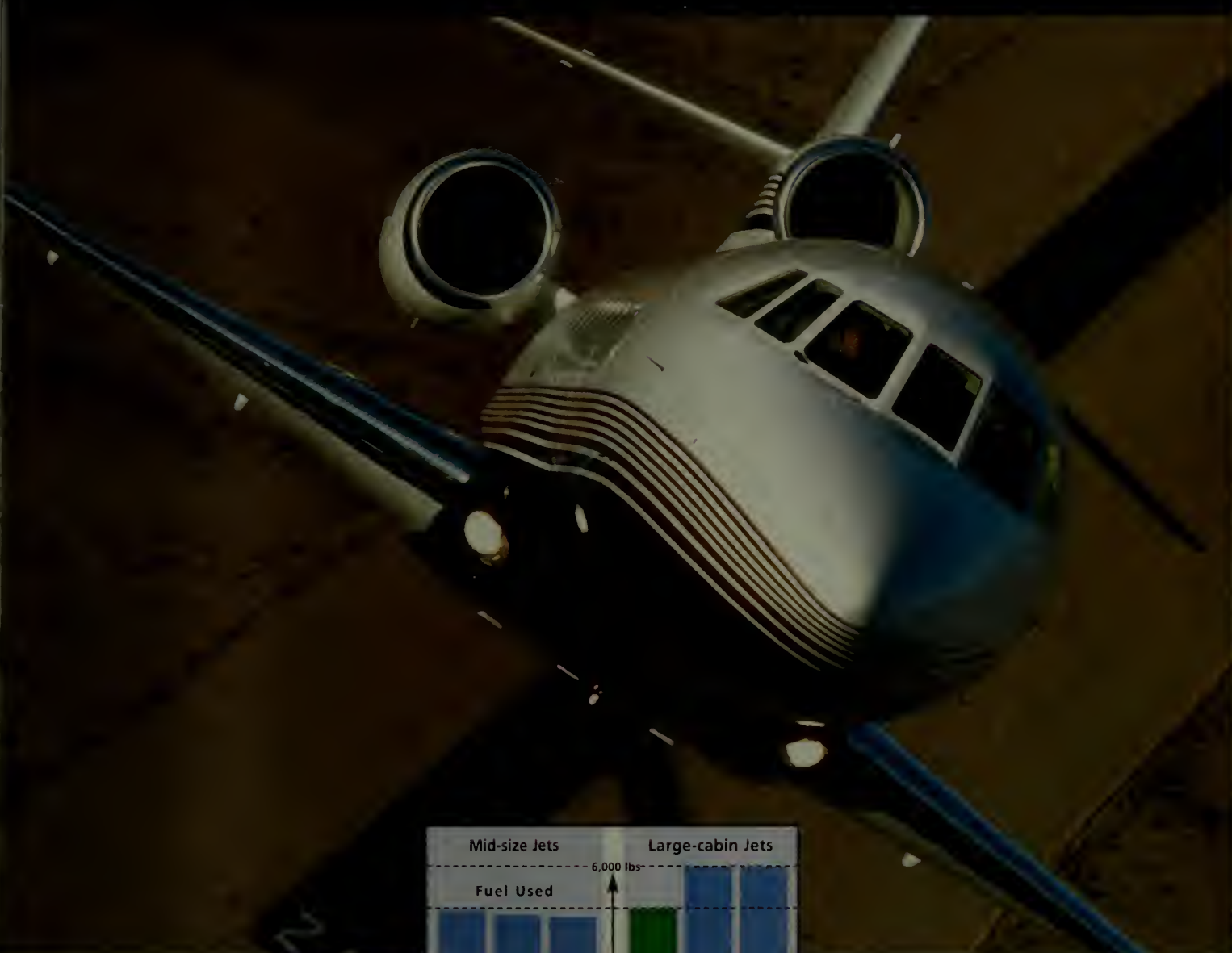


MANY YOUNG GOLFERS SEE THE NATIONWIDE TOUR AS THEIR BIG CHANCE.

toughest courses, the conversation quickly comes back to the Nationwide Tour. If the PGA follows through on a proposal to award world ranking points to top finishers at Nationwide events, Jurgensen believes that could entice more international players to join his tour. "[PGA Commissioner] Tim Finchem may hate to hear me say this, but I think in 10 years you could have two golf tours in the U.S. that are comparable in talent, like the old AFL and NFL."

While the developmental tour has endured a parade of sponsors such as Nike and Buy.com that eventually chose not to renew their contracts, just two years into his current deal, Jurgensen is hoping Nationwide remains a fixture on the pro golf scene for years to come. "You never know what happens at contract renewal, but I think the PGA Tour and Nationwide found each other at the right time," he says. The pairing may prove that gold is found on the path least taken. ■

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Driven to Succeed

» The stakes have never been higher in the ultra-competitive driver market, where companies are taking huge risks in hopes of hitting it big

By Mark S. Murphy • Illustration by Aaron Goodman

IMAGINE STANDING ON THE 18TH tee at Pebble Beach Golf Links. The ocean is on your left as the hole bends around the bay for its entire 543 yards. The more water you bite off with each shot, the better chance you give yourself to birdie, or maybe even eagle, the hole. But get greedy or mishit a shot, and you end up on the rocks—the classic risk-and-reward golf hole.

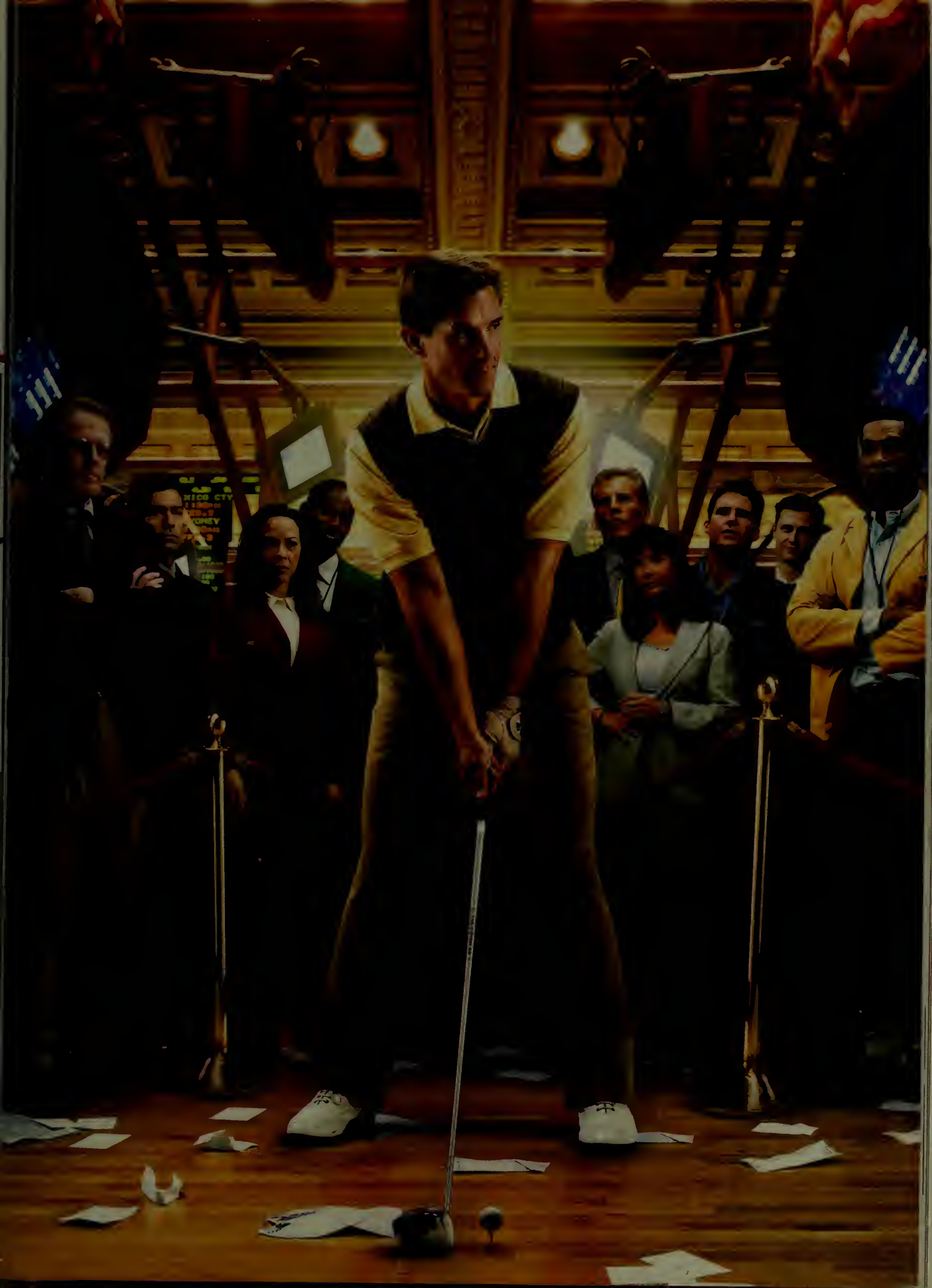
It is much the same story in the market for drivers. As the pressure to perform has ratcheted up across the whole economy and especially for publicly traded companies, golf equipment manufacturers have taken big risks to develop a hit driver. The rewards are tremendous, but the cost of failure can be huge.

“To do well, to support your other activities, you need a big driver success,” says Sean Toulon, executive vice-president and general manager at TaylorMade-Adidas Golf, a division of Adidas-Sa-

lomon. “For us, that is even more true. As the driver business goes, so goes the company.”

If that is the case, then Toulon’s team is moving his company in the right direction. From the middle of May through the end of August, golfers have bought more than 38,000 TaylorMade r7 quad drivers and its sister r7 quad TP at a minimum price of \$480 (the r7 quad TP retails for \$750). Both are well above the average price paid for a metal wood—\$178 in August, according to the research firm Golf Datatech—and for that same month they accounted for one-half of all clubs that sell for more than \$300.

The reason is relatively simple. The r7 is an ingenious blend of technology and marketing that has captivated the market’s attention. The attraction of the r7 lies in the ability each golfer has to modify the weight distribution within the all-titanium head by moving four weighted cartridges with a specially designed wrench to different loca-



tions, depending on what kind of ball flight the player wants. The TP version supplies more weights and, the company believes, more chances for the golfer to create an ideal ball flight.

Leigh Bader, co-owner of Pine Oaks Golf Course near Boston and 3balls.com, one of the leading sellers of golf equipment on eBay, thinks that the r7 is the right club at the right, techie time. "The audience is mostly male, and they love their tools," he says.

What a difference a few years make. In 1999, Callaway was dominant, accounting for almost a third of all drivers in use, led by the Great Big Bertha, and its successor, the Biggest Big Bertha. Through the summer of 2003, Callaway's share had declined by a third, according to the latest Darrell Survey research. But Callaway's tailspin is not simply a result of TaylorMade's success. It is also a function of the less-than-overwhelming reception that its recent driver releases, including the titanium/composite ERC Fusion, have received. "Callaway used to dominate the driver segment six to seven years ago," says Callaway Golf President and COO Patrice Hutin.

"Maybe we have taken our eye off the ball a little bit."

Bader delivers a more detailed critique. "Callaway's issues are textbook of a technically capable company that was disconnected from the market," Bader says. "There has been a disconnect between research and development and product development. They weren't taking the pulse of society in general and then drilling down to golf to see what the market would accept."

Says Tim Conder, a senior leisure analyst for A.G. Edwards: "They've fallen behind the R&D curve," he says, harsh criticism for a company that prides itself on its technological prowess. The Big Bertha driver in 1991 led to the Big Bertha fairway wood, which led to the Big Bertha iron in 1994—all of them groundbreaking and all of them putting the company in a leading position in those categories.

» "As the driver business goes, so goes the company,"

says Sean Toulon, executive vice-president and general manager at TaylorMade-Adidas Golf.



"They're just out with a hybrid," says Conder. "The [White Hot] 2-Ball [putter] has been a phenomenal success [for Callaway's Odyssey brand], but it's a little long in the tooth. You have to continually innovate, whether it's perception or reality."

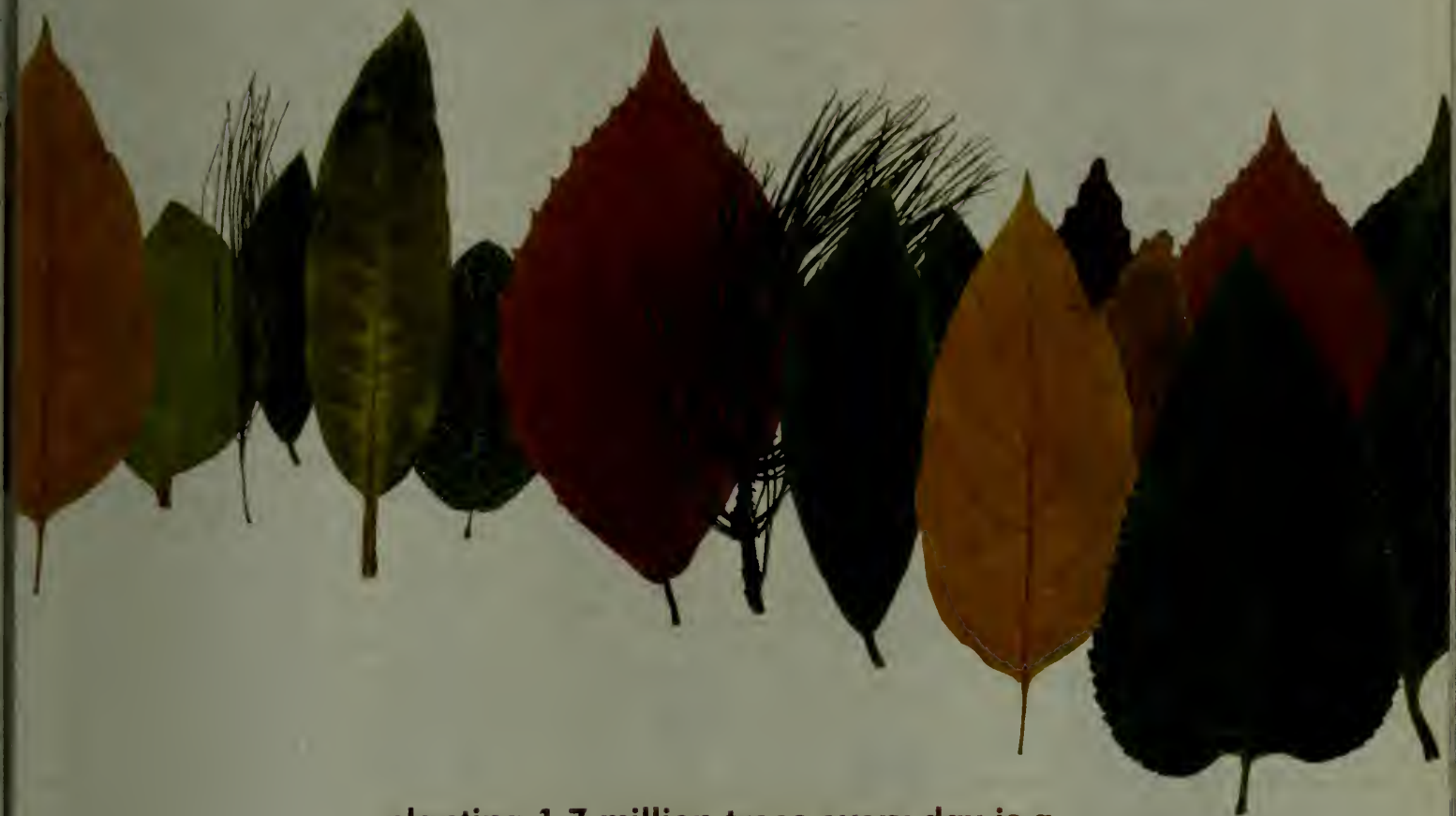
As the largest pure-play public golf enterprise, Callaway's results are available for all to see. The most obvious casualty of the company's poor performance was Ron Drapeau, who resigned Aug. 2 as chairman and CEO. Since reporting that second-quarter sales and earnings would not meet expectations, Callaway twice has revised its earnings guidance. Wall Street was quick to judge those actions. On the days after the revisions, Callaway's stock declined 21 percent and 16 percent, respectively.

TaylorMade's r7, meanwhile, has been making news since May 16, when it was used by Sergio Garcia to win the EDS Byron Nelson Championship. The same week it became the most used driver on the PGA Tour a month after being introduced. But not all news has been good. Taylor-

Made's first quarter was weak, punctuated by an operating loss. Not long after that came a series of resignations and reassignments in top management, which the company and individuals involved say were unrelated to company performance. President and CEO Mark King remained unscathed and in charge.

What King and his competitors are facing is a market in which a hit—any hit, even a single or a double—is important, but the stakes of striking out are enormous. The reason for that is simple. The metal-wood market has gotten significantly more competitive the last five years. Since September, 1999, metal woods from Cleveland Golf (a division of Skis Rossignol SA), Cobra Golf and Titleist (divisions of Fortune Brands), Nike Golf, and Ping have more than doubled their combined market share, to 28 percent. All five of those companies have revenue of more than \$100 million, which in the \$3 billion retail golf equipment market makes them big players. Throw in Callaway and TaylorMade's combined share of 36 percent and you account for nearly two-thirds of the market. It's an

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economic landscape that is all about trading share points.

"It's a mature, consolidating market at retail and manufacturing," says A.G. Edwards' Conder. And in that market, "the guys who win are low-cost producers and those who make something people have to have." Despite the success of the r7 and the potential of Fusion, it's not clear how much room there is for product differentiation. "Realistically, the leap from wood to stainless steel was big," Conder says. "From stainless to titanium was big. But will the leap from titanium to composites and titanium be revolutionary?"

Callaway believes the Fusion composite/titanium technology is revolutionary. But the company knows how difficult the market has become. One thing Drapeau did before resigning was cut Callaway's prices on all its metal woods, including Fusion.

Casey Alexander, a special situations analyst for Gilford Securities, says prices will come down across the board during the next several years, and profit margins for drivers will be more in line with margins for other clubs. "We are in the salad days of the driver right now," he says.

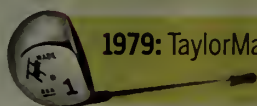
TaylorMade's Toulon says that drivers are 20 percent more profitable than the rest of the company's clubs, and he is counting on that to continue. "We would do virtually anything, spend every nickel we have, to defend the driver, that's how important it is."

The company doesn't release R&D figures, but with more than 60 engineers on staff, TaylorMade's commitment to innovation is evident. Callaway also considers technological advancements key to the company's success, having spent an average of \$31 million a year since 2000 on R&D, or about 4 percent of sales.

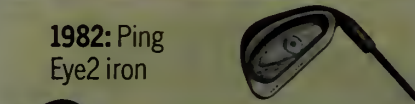
However, developing the next great driver isn't enough; creating demand for that club is part of the equation, too. Marketing takes many forms, but the

Change agents

Some products not only perform well in the market, they transform it. Without them, golf equipment would not be where it is today. In the last quarter century, only a handful of products have fit that category, even though they might not have pioneered the technology the product made popular. It's too soon to tell if Callaway's Fusion driver and TaylorMade's r7 quad driver fit the bill in that regard.



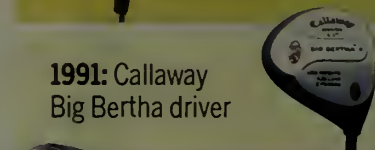
1979: TaylorMade metal wood



1982: Ping Eye2 iron



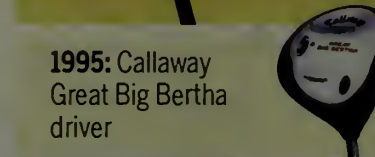
1985: Ping Eye2 lob wedge



1991: Callaway Big Bertha driver



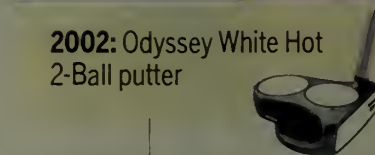
1994: Callaway Big Bertha iron



1995: Callaway Great Big Bertha driver



2001: Titleist Pro V1 ball



2002: Odyssey White Hot 2-Ball putter

most important component in golf is presence on the PGA Tour.

In May, 2000, Tiger Woods switched from a wound-construction Titleist to solid-construction Nike golf ball and the reeled off four consecutive major-championship titles. Titleist responded that fall with the first version of the Pro V1. Within weeks nearly all of Titleist's staff players were using it. Consumer acceptance followed the next spring and has grown since then, through two updates and two additional versions.

Jim Thompson, president and CEO of Golfsmith International, the country's largest golf retail chain, says that Titleist is successful because its marketing approach is strategic. "They're a brand first. The only way to manage the ball business is to make sure it's validated on tour," he says. Thompson believes TaylorMade is taking a similar approach with the introduction of the r7. "Mark King is taking brand view of TaylorMade, not a product view," Thompson says, and the company is investing in marketing that will accrue to the r7 as well as its successors.

How does TaylorMade follow up on the r7? "We are practicing relentless innovation," says Toulon. "We have launched more products in the last five years than in the first 20," with the strong implication that the pace won't slow. He knows that if you're standing still, you're falling behind.

In September the r7 was joined by two r5 drivers (street price: \$329) in TaylorMade's line, as the company attempts to use the early success of its premium product to drive consumers to what it expects will be the meat of the market. (For good measure, TaylorMade said it would add an r7 HT—high trajectory—to the line as well.) It is a risk to assume golfers will connect the dots that the company has so carefully printed onto the market.

Since the month before the October 2000 launch of its 300 Series of drivers—turning point in the company's recent performance—TaylorMade's unit share in metal wood has increased by a little more than 41 percent, ac-

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cording to the latest Golf Datatech research. At the same time, the average price paid per wood has increased nearly 19 percent.

But the halo effect of a successful driver goes beyond that category. Since June, 2001, the month before TaylorMade launched its 300 Series irons, the company's share in irons has remained static. However, the average price paid per club has increased almost 24 percent.

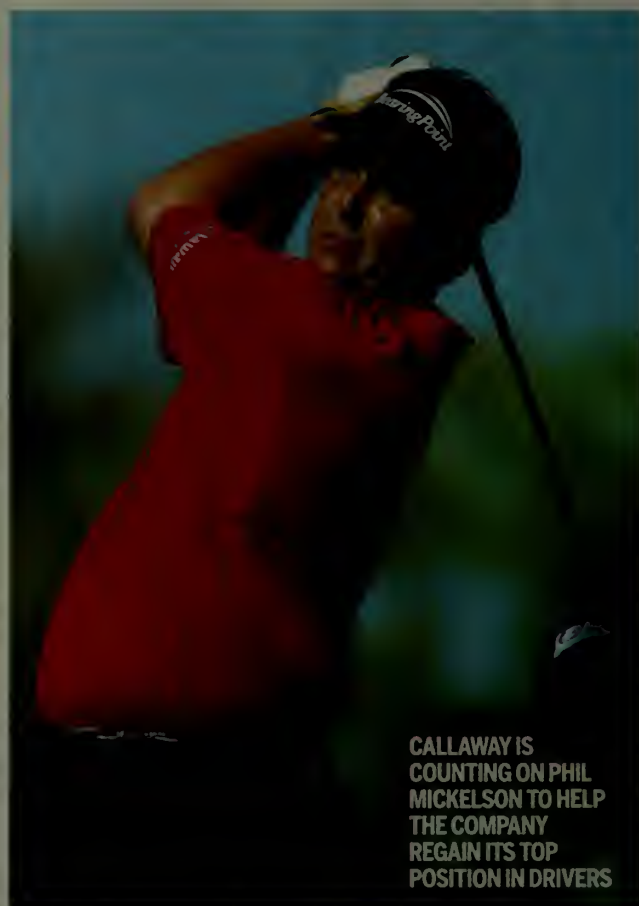
Although the r7 is a terrific driver for tour-caliber players—just ask Vijay Singh what he has been hitting off the tee since mid-summer—it is not for everyone. There are more forgiving drivers on the market, and although some golfers love tinkering with the weights, others might find it too complicated. The r5 is a bigger-headed driver, and the weights are permanent.

Unfortunately for golf retailers and their inventory positions, TaylorMade is not alone in trying to win new consumers by coming out with a lot of new products. The shelf life for new drivers proves just how difficult the market has become. Titanium drivers unveiled in 1999, 2000, and 2001 averaged 17 months at their original retail price, according to Golf Data-tech. Drivers introduced in 2002 and 2003 lasted an average of 10 months at full retail. Great Big Bertha, the first hit titanium driver, stayed at its premium price point for 33 months.

Ken Morton Jr. is director of retail and marketing for Morton Golf LLC, which operates three municipal golf courses in Sacramento, Calif., and is recognized as one of the country's leading golf retailers. "It's confusing to retailers and to consumers. It's become like buying a new computer. [A club] is obsolete the minute you open the box," Morton says. And it forces retailers to push prices as low as they can to attract customers.

Toulon recognizes the difficulty. "Not everything we have done has made sense to our customers, and we're focusing on that," he says. Oth-

»Having a presence on the PGA Tour is an important component to marketing a driver.



CALLAWAY IS COUNTING ON PHIL MICKELSON TO HELP THE COMPANY REGAIN ITS TOP POSITION IN DRIVERS

er manufacturers are not likely to sit around to see how that situation works itself out. Callaway's Hutin believes that eventually his Fusion drivers will compete with TaylorMade. "The Fusion as a technology platform is very successful," he says. "The first product was as successful as we expected, but it was not a runaway success. We could have done better."

One of the first steps in challenging TaylorMade was the September signing of Phil Mickelson to endorse Callaway products, including his promise to play a second generation of the Fusion. Still, using one player for brand validation can be tricky. Mickelson's performance at the Ryder Cup with Callaway's Great Big Bertha II driver and Big Bertha fairway woods was criticized.

Hutin would not specify when Mickelson will switch to the updated Fusion, but he remains bullish on the product. "We have demonstrated to ourselves through our work with Phil that the platform is extremely powerful and flexible. It will definitely give him great benefit, but it will also benefit other players," Hutin says.

Who knows whether Mickelson or Woods or world No. 1 Singh will make the difference or whether Fusion or weights or some as-yet-undeveloped material will promise greater distance and accuracy. What is clear is that well-funded competitors, retailers who drive down prices, and consumers who have so much choice of solid products are making the big players in the market work harder for their success.

"Are the stakes higher today?" Morton asks. "For those on the top, yes. With the game not growing, the odds of increasing market share aren't great. The only way to go is backward. Callaway did a fantastic job of staying on top," he says. "But brands like Cleveland and Cobra have lots of potential growth. They can afford to bite it off in small chunks and keep growing." ■



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BY ROBERT BARKER

Callaway Golf: It May Look Like a Hazard...

For all the talk on golf courses about investments, investing in the game itself has proved no gimme. Sales of golf gear at a trio of big players—Adidas-Salomon, Fortune Brands, and Nike—make up modest parts of their total. Purer plays tend to be micro caps. So investors have tended to focus on Callaway Golf.

Lately that move has caused them dismay. Shares of Callaway, a leading maker of clubs, balls, and sundry golf stuff, have been sliced nearly in half, to under \$11, since spring. The culprits? Write-offs following its 2003 purchase of rival gear maker Top-Flite Golf, for one. But the worst was sales of its drivers as Adidas' TaylorMade r7 quad took pro shops by storm. So far this year net income has fallen 77%, despite an 18% rise in sales, as Callaway slashed prices to move goods.

Despite its stumble, Callaway to me looks better than you might expect. The Carlsbad (Calif.) company's balance sheet and cash flow are in reasonable shape. What's more, even though a spokesman told me flat out that the company has no plan to prepare itself for a sale, I suspect odds of such an outcome are growing. One reason: The board in August installed its longest-serving member, William Baker, as CEO. He quickly froze product introductions while he studies the business. He also decided to quit giving earnings guidance.

SO INVESTORS ARE SCRATCHING their heads trying to discern Callaway's future direction and earnings. Although Callaway enjoys a reputation for innovation, research and development spending has run flat lately even as overhead has grown (chart). The recent signing of current Masters champ Phil Mickelson to a multiyear endorsement contract worth \$7 million to \$10 million a year plus possible bonuses and stock likely swelled its selling costs. He joins ladies' tour pro Annika Sorenstam as the top Callaway endorsers. Just the same, through 2004's first three quarters, operations generated cash flow of \$46 million. That's down from \$140 million the previous year, but even after capital spending, acquisitions, share repurchases, and 7¢-a-share quarterly dividends, operations still created more cash than the company used. The balance sheet, with \$67 million in cash, is unburdened by debt. Meanwhile, the company



SORENSTAM
Callaway has upped its marketing budget

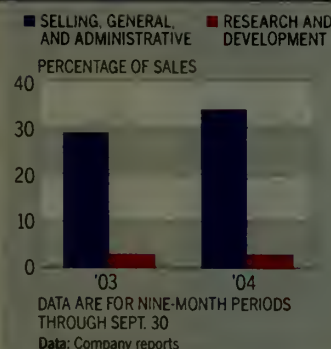
says retailers' inventories now are pretty well cleared.

It's in even better shape—low stock price, resilient cash flows, and lean balance sheet—to attract one of the umpteen private-equity funds hunting for companies to buy. Another possible buyer is an industry rival. Antitrust objections would likely scotch a purchase by Adidas or Fortune Brands. Nike, with smaller market shares, may be more likely. A Nike spokeswoman told me the company never discusses market speculation about deals. Also, Nike traditionally has focused on building its own brands. More recently, its purchases of Converse sneakers and teen-apparel maker Hurley International, which run on a long leash to maintain their brand identities, have signaled a broader strategy. With a stock-market value near \$700 million, Callaway would be a small bite for Nike, which generates \$1.5 billion a year in cash.

There's one more reason I suspect the odds of a deal for Callaway have grown: the choice of Bill Baker as CEO. Baker built the Del Taco restaurant chain, then sold it in 1988. Later, he helped to lead the La Quinta real estate investment trust through a series of deals. Now 71, he let Chief Financial Officer Brad Holiday do most of the talking during an Oct. 19 conference call with stock analysts. The Callaway board has hired no executive-search firm to find his replacement. Baker told the analysts: "I will be the CEO of this company for the foreseeable future." Just how long that will be, he didn't say. ■

E-mail: rb@businessweek.com

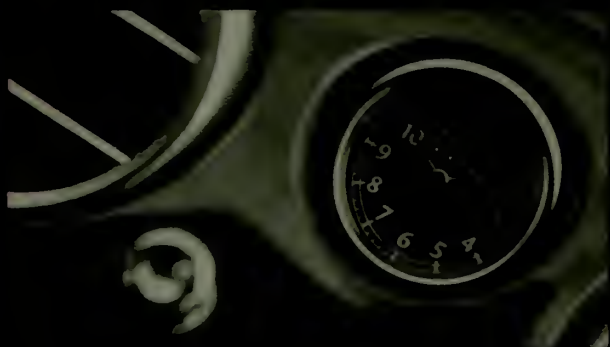
CALLAWAY'S R&D LAGS





BENTLEY

PRESTIGE AND PERFORMANCE United under a "winged B", Breitling and Bentley share the same concern for perfection. Extreme standards of reliability, precision and authenticity. A world where cutting-edge technology merges with noble traditions. The ultimate blend of prestige and performance. Symbolizing this communion of ideals, Breitling participated in the styling of the instrumentation for the Bentley Continental GT and accompanied the victory of Team Bentley in the legendary Le Mans 24 Hours race.



EXCLUSIVITY AND TECHNICAL EXCELLENCE For devotees of fine mechanisms, Breitling has created an exceptional chronograph named Bentley Motors. The culmination of sophisticated aesthetic research, this wrist instrument mirrors certain signature features of the famous British car manufacturer, such as the knurled finish on the bezel, inspired by the Bentley controls. Dedicated to the automobile world, it features two exclusive mechanisms as well as a high-performance "motor" assembled and "prepared" in the Breitling Chronométrie workshops.



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BY GENE G. MARCIAL

WHY MIDWAY GAMES IS HIGH IN SUMNER REDSTONE'S PORTFOLIO.

NEW TECH PRODUCTS HAVE PUT XEROX BACK IN THE PICTURE.

A BUYOUT OR A BREAKUP MAY LOOM FOR DOUBLECLICK.

Set to Move on Midway?

FOR MOST PEOPLE, food tops their shopping list. For billionaire Sumner Redstone, it's a stock: Midway Games (MWY). "I buy shares of Midway almost every day," says the Chairman and CEO of entertainment giant Viacom. As of Nov. 1, Redstone himself owned 63.3 million shares. That's 75% of the maker of software for video games, played on platforms like PlayStation (R)2, Xbox, and Game Boy. Mortal Kombat is its No. 1 game. Redstone has paid as much as 13 for the stock. Now at 9.78, Midway was featured in this column on July 29, 2003, when it was at 4.52. The \$25 billion game business is "the fastest-growing in entertainment," notes Redstone, and it "will compete with TV—for audiences and ads." So the networks "need to be in it," he argues. The talk is that he'll take Midway private—or that Viacom or another company will acquire it. In August, Viacom formed a committee of independent directors to evaluate all possible deals with Midway. Although the Street is down on the stock, one insider sees it hitting 20 in two to three years—just on fundamentals. Redstone says analysts still view Midway as the old company—before ex-Disney and ex-ESPN exec David Zucker took over as CEO in mid-2003. He credits Zucker for turning around Midway—after five years in the red. Zucker says Midway, rated No. 1 in quality by industry reviews, will post a profit in the fourth quarter. He won't comment on 2005. He has inked deals with studios to make movies out of its games, including a new Mortal Kombat sequel. Edward Williams of securities firm Harris Nesbitt—neutral on the stock—says Midway "doesn't trade on conventional valuation metrics." It "simply trades on what Redstone is willing to pay."



REDSTONE Game boy

here on Dec. 2, 2003 at 8.66. The stock, says Lane, has built a strong base since hitting a low of 3.75 in 2000, from which it has been pushing higher. Technimentals' Joseph Phillips says Xerox is moving to new-tech digital and color products, with sales growth offsetting declines in old-tech businesses with thin margins. Xerox has rolled out or announced 35 new products this year, such as a high-speed, 120-sheet a minute digital copier. Its profitable color copiers and printers account for 24% of revenues. Jay Vleeschhouver of Merrill Lynch, which did banking for Xerox, rates Xerox a buy, and upped his net forecast for 2004 to 83¢ on sales of \$15.6 billion, and for 2005 to 93¢ on \$16.4 billion.

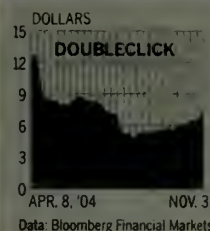
A CRISP NEW IMAGE



Why DoubleClick Is Getting Second Looks

LONG RUMORED to be takeover bait, DoubleClick (DCLK), a provider of Web services to ad agencies and online marketers, may finally get bought out: On Nov. 1 it hired Lazard to explore options—including a sale of all or parts of its business. The stock, which dropped to 4.52 in August on soggy earnings, jumped on the news—from 6.36 on Oct. 29 to 7.21. Martin Pyykkonen of Janco Partners, who rates it "accumulate," says DoubleClick could find separate buyers for its data division, which helps catalog marketers manage mailing lists, and its tech unit, which handles clients' ad programs. A hedge-fund manager who owns stock says DoubleClick's cash stash of \$400 million, or \$3.50 a share, and its tax-loss carryforward of \$200 million, or \$1.50 a share, may attract a buyer for the entire company. He puts the takeover value at 10. Pyykkonen sees DoubleClick earning 23¢ in 2004 on sales of \$293 million, and 25¢ in 2005 on \$335 million. ■

EDGING UP—ON BUYOUT TALK



Raising the Toner At Xerox

OUT WITH THE OLD TECH, in with the new—at Xerox (XRX). Apart from technology, an improving image is also new for the stock, which jumped from 10 last year to 15.72. A recent bull is Redwood/Technimentals Research, which mixes technical and fundamental analysis in sizing up stocks. Chief strategist Kevin Lane just flashed a "buy" on Xerox, with a 12-month target of 22. Xerox was highlighted

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



Environmental Solutions: 2004

To read full reports and related information, go to the links listed below or visit www.environmentalresource.com

Portable Vapor Control Technology Achieves Compliance and Preservation

In today's governmental regulatory community, environmental compliance continues to mandate high demands on industries possessing the risk and potential of liberating hazardous air pollutants to the atmosphere. These compliance standards are implemented to ensure emissions control measures are satisfactorily engineered in an effort to reduce any health risks that may be associated with varying emission sources. Emission sources are comprised of stationary as well as mobile sources. Industries, such as manufacturing, petroleum, chemical and environmental remediation, etc. have assessed the risk and health impacts associated with their emissions and the need to establish the best

available control technologies (BACT), hence, providing a resolution to minimizing environmental exposure.

Owner facilities have evaluated various technologies in controlling and destructing hazardous emissions, which emanate from their processes. These control technologies are particularly critical when there is potential of various process components and their commodities becoming exposed to the atmosphere. This results from mandates regulating preventative maintenance procedures affecting a variety of processes.

As a resolution to controlling vapors from these emission sources, industry has recognized portable vapor destruction as a mitigating effort. Although not a

new application, vapor destruction has become more prevalent in the industry for its efficiency and portability. In contrast to fixed-stationary vapor destruction units, portable vapor destruction units can be mobilized to various locations achieving the same purpose.

Portable vapor destruction may be achieved through internal combustion engines and/or thermal oxidation technology. Internal combustion engines utilize the existing gases in a process as a fuel source, thus combusting the vapor. Likewise, thermal oxidation processes destruct the vapor by introducing the vapor into a flame combustion compartment rendering the final decomposition of the vapor. This technology lends industry the ability to achieve compliance as an alternative source of vapor recovery while securing an ongoing method to preserve the environment.

To read the full report, go to
www.environmental-resource.com/ancon.as



Ancon Marine is a full service environmental company with extensive experience in the environmental and industrial services industry. Headquartered in Carson, CA, Ancon's service portfolio includes; Vapor Destruction, Hydro-blasting, Tank Cleaning, Air Movers, Emergency Response, Vacuum Trucks, Sewer Jetting, Transportation, Odor Abatement and Waste Management. Ancon's offices are located in Carson, CA, Stockton, CA, Phoenix, AZ, and Las Vegas, NV. Contact Mr. Bret Hardin - President at 310.522.5110 for more information. www.anconmarine.com

Project Dashboard Applications Lead to Better Business Decisions

Few would argue that periodically reviewing and updating strategies and approaches is critical to successfully managing a business. After all, one does not apply the same techniques, tools, and strategies in managing a start-up as one does a mature business. Just as you analyze your business and its markets throughout its stages and adjust your strategies accordingly, environmental programs and liabilities can, and should, be evaluated and managed taking their evolutionary nature into account. Failure to do so, inevitably results in projects that take longer and absorb more resources than necessary.

The idea that environmental projects go through

phases that require changes in strategy and technology (sometimes drastic changes) to ensure they are addressed in the most efficient and cost-effective way possible is typically referred to as "Remediation Life Cycle." The concept has been around for years and enjoys widespread acceptance among environmental experts. Yet, it is not a concept that has been effectively employed to any great extent. Why? A primary reason is that the typical environmental project generates voluminous data that are extremely cumbersome to manage and evaluate in an effective and meaningful fashion. Thus, reevaluation of project data to optimize approach has historically been undertaken only sporadically, often

at long intervals and driven by regulatory concern rather than economics and efficiency. However, a new generation of tools is emerging to facilitate this process.

"Project Dashboard" applications have become a powerful new way of providing project information to decision-makers at environmental sites. Combining industry-leading IT applications such as Geographic Information Systems (GIS) and web services to develop Project Dashboards creates integrated vehicles that allow project managers and owners to evaluate data, analyze relationships and trends, and update site conceptual models and strategies in real time. These applications also allow the sharing and discussion of data and ideas among project members at disparate locations, which can further facilitate decision making and reduce costs.

To read the full report, go to
www.environmental-resource.com/trihydro



Trihydro is a nation-wide engineering and environmental consulting firm whose employees are committed to providing professional technical and contracting services that support its clients' business needs and objectives. With more than 20 years experience, Trihydro provides expert, safety-oriented specialized services that result in high-quality, value oriented solutions. Trihydro is dedicated to merging the right mix of leading edge IT solutions with tried-and-true science and engineering to achieve its clients' goals. www.trihydro.com

Environmental Solutions: 2004
For in-depth reports on these
and other environmental topics, visit
www.environmental-resource.com



Read full reports and related information, go to the links listed below or visit www.environmental-resource.com

Smart Compliance Strategies Can Significantly Reduce Costs

Facilities have environmental compliance options. A thorough knowledge of regulatory alternatives and utilization of smart compliance strategies can result in a significant improvement in a facility's bottom line.

It is possible for facilities to maintain environmental compliance and, at the same time, reduce costs. The key is having either thorough, current regulatory knowledge or retaining experts in the field to capitalize on compliance options. This process is referred to as smart compliance strategies. Examples include demonstrations of similarity, delisting petitions, and comparable

fuel exclusions, to name just a few.

Many facilities have multiple units with duplicate compliance requirements. A successful demonstration of similarity can eliminate costly compliance testing in the range of \$50,000 to \$250,000 for each similar unit. A RCRA delisting petition demonstrates that a benign waste stream is not hazardous to the environment, and can be transported and disposed as a less expensive non-hazardous waste. The cost savings realized by a facility can be as much as \$250,000 or more per year for each waste stream. One smart exemption is a RCRA comparable fuel exclusion for a clean and energetic

hazardous waste stream. Comparable fuels are not considered to be hazardous, and thus remove the onerous compliance burden and costs for a facility.



From the above examples, and many others like them, the development of smart and proactive compliance strategies will improve the bottom line of a facility.

To read the full report, go to
www.environmental-resource.com/cs2.asp



Compliance Strategies & Solutions, Inc. (CS₂ Inc.) is great at developing innovative compliance strategies and offering superior service to meet the environmental needs and cost concerns of facilities. CS₂ Inc.'s compliance strategies offer a return on investment while ensuring regulatory compliance for facilities. Houston, TX • 281.286.1861 • www.cs2inc.com

Pollution Prevention/Minimization of Waste Could Save You Big Money!

Most companies have established criteria and policies encouraging Pollution Prevention/Waste Minimization. This is typically approached through engineering, process modifications and purchasing reviews, all in an attempt to reduce the generation of waste. There is another approach available that companies seldom use. This approach is based on regulatory definitions for solid and hazardous waste. If you do not meet the definition of a solid waste, you are not subject to regulation under the Resource Conservation and Recovery Act (RCRA) and can not generate

a hazardous waste.

To take full advantage of this approach it is necessary to review the regulations thoroughly. The Environmental Protection Agency (EPA) has devoted considerable space in the regulations for definitions and exemptions, which are found in 40 CFR §261. One of the major areas of flexibility occurs in dealing with commercial chemical products. Did you know that commercial chemical products are not considered solid wastes if they are applied to the land and that is their ordinary manner of use? Also, if a commercial chemical product is burned for

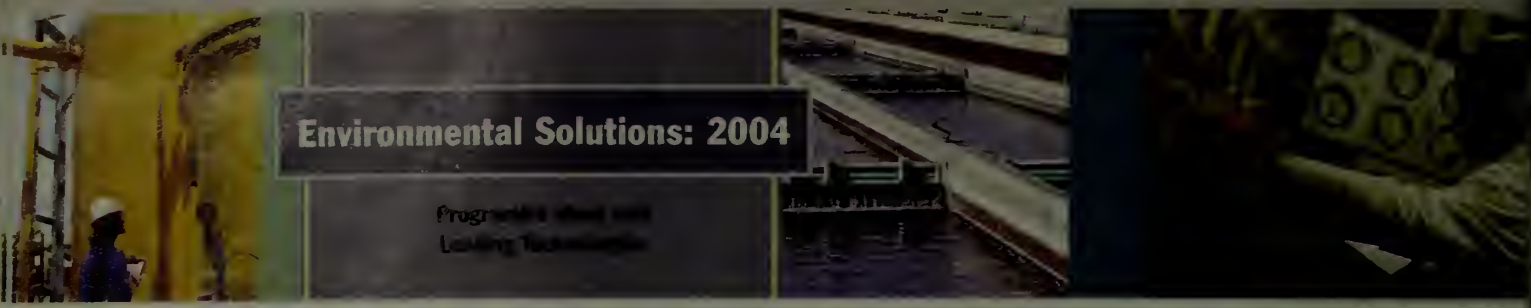
energy recovery it is not considered a solid waste if it is itself a fuel.

Are you currently managing commercial chemical products as waste? You may find it advantageous to re-evaluate your decisions and keep this material in the "product" category. Commercial companies are emerging that can assist with a product exchange service, thereby reducing your generation of waste. This can translate directly to the bottom line, as well as assisting your company in meeting the ambitious pollution prevention/waste minimization goals established by management. The main message here is to be certain that you exhaust all of your options by fully understanding the regulatory basis of the RCRA program.

To read the full report, go to
www.environmental-resource.com/envman.asp



Environmental Management, Inc. is an Oklahoma-based company with over 20 years experience providing environmental services throughout the United States. The company is located in Guthrie, Oklahoma and utilizes a nation-wide network of sub-contractors to provide services including Emergency Response, Solid and Hazardous Waste Collection and Disposal, Remediation Services, Other Miscellaneous Waste Management (Tank Cleaning and Removal), Environmental Consulting, and Damaged Freight Management. Contact: Terry Bobo: 405.282.8510 • www.emiok.com



Environmental Solutions: 2004

Programs about water
Leaking Technology

To read full reports and related information, go to the links listed below or visit www.environmental-resource.com

Do You Work in a Healthy Building?

How much time do you spend in your office? Is it making you sick? The energy crunch of the 1970s prompted industry to build tighter more energy efficient buildings, but now many of these buildings have become "sick". When is a building considered sick? While there isn't a simple test to determine this, some of the warning signs include: poor temperature and humidity control, odors from the kitchen or cleaning supplies permeating the building, and people complaining of headaches, flu like symptoms or tiredness. Many of these symptoms can be caused by poor ventilation, high carbon dioxide levels,

inadequate outside air, poor filtration or lack of humidity control.

How can you determine if your building is healthy? Commissioning is a process used in new construction to test and verify that integrated systems are functioning properly. Retro-commissioning is the process used in existing buildings to evaluate, test and verify systems are operating in accordance with the design intent and accepted codes and standards. During retro-commissioning, the commissioning authority will determine if adequate amounts of outside air are being delivered, if

equipment is clean and operating properly, and if the control system is working properly.

The perception is that creating a healthy building is incompatible with energy efficiency, because more energy is required to condition greater volumes of outside air. Healthy buildings and energy efficiency are not incompatible. A Commissioning Authority can provide cost effective solutions to maintaining healthy indoor air quality (IAQ) without impacting the energy efficiency appreciably. In fact, the EPA has found that a properly commissioned building meeting the IAQ standards, can operate at a 10-15% savings compared to a typical building. In addition, studies have shown a direct link between IAQ and employee productivity, providing an excellent return on investment for commissioning.

To read the full report, go to
www.environmental-resource.com/primera

PRIMERA

Primera Engineers, Ltd. is a growing and diversified engineering firm, offering professional services in the disciplines of mechanical, electrical, plumbing, commissioning, telecommunications, infrastructure and construction management. Primera believes that the core of a great company is the dedication to these principles: (1) Be a company that quality-driven professionals are proud to be a part of (2) Be uncompromisingly passionate about client service and client satisfaction. Chicago, IL • 312.242.6342 • eaello@PrimeraChicago.com • www.PrimeraChicago.com

Effective Radium Removal with HMO

Radium contamination of groundwater is a serious public health issue addressed by the USEPA in the Final Radionuclides Rule effective December 8, 2003. This rule sets a maximum contaminant level (MCL) of 5 pico-curies per liter (5 pCi/L) for radium. Design and manufacture of equipment for removal of this health hazard is a priority for water treatment equipment manufacturers.

Radium Removal Technologies

There are several BAT technologies identified by the USEPA for radium removal. These BAT technologies are also softening techniques, so unless soft-

ening is also a treatment goal for the water utility, these processes can be costly and unnecessary. Hydrous manganese oxide (HMO) addition has also been identified by the USEPA as an acceptable technology for radium removal in groundwater supplies.

Hydrous Manganese Oxide

HMO addition involves the preparation and controlled dosage of a pre-formed manganese oxide solution to raw water prior to filtration. Radium is adsorbed on the surface of the added HMO particles, which are subsequently filtered. Because the HMO is backwashed out of the filter media, radium accumu-

lation (a downfall of other processes) does not occur.

This treatment approach for radium removal has been extensively studied and documented in an American Water Works Association Research Foundation (AWWARF) study conducted by Dr. Richard Valentine, Professor at the University of Iowa. HMO technology can be integrated into existing water treatment facility removing iron and/or manganese, or can be used in a treatment facility specifically targeting radium removal.

Proper engineering considerations in the HMO delivery system and overall treatment plant design are critical to optimal operation and radium removal performance. An appropriately designed HMO treatment system is a very cost effective, safe and trouble free solution to radium removal.

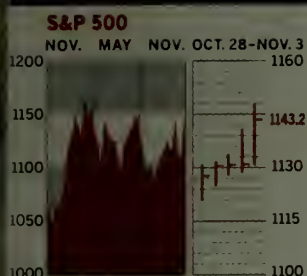
To read the full report, go to
www.environmental-resource.com/tonka



Tonka Equipment Company manufactures customized water treatment systems for municipalities across the United States and abroad. Tonka provides cost-effective solutions for the most challenging surface and groundwater problems, including arsenic, radium, and nitrate removal. Tonka's Simul-Wash™ combined air/water backwash system provides superior media cleaning while reducing backwash water volume by 50%. Plymouth, MN • 763.559.2837 • www.tonkawater.com

Personal Business Figures of the Week

STOCKS



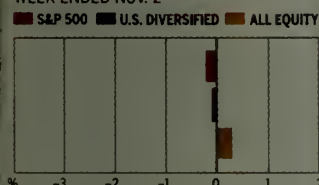
COMMENTARY

President Bush's decisive victory ignited a big rally on Nov. 3, sending stocks soaring. The S&P 500 index climbed 1.1% that day, hitting a four-month high. The move was broadbased, ranging from tech stocks to financials. Lower oil prices added to the optimism. The lone party pooper? The bond market, which is worried about Bush's mounting budget deficits.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	NOV. 3	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1143.2	1.6	2.8	7.9
Dow Jones Industrials	10,137.1	1.4	-3.0	2.8
NASDAQ Composite	2004.3	1.7	0.0	1.9
S&P MidCap 400	609.6	1.3	5.8	9.8
S&P SmallCap 600	302.8	1.4	12.0	15.8
DJ Wilshire 5000	11,189.4	1.5	3.6	9.9

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	660.7	1.3	6.2	9.7
BW Info Tech 100**	346.4	2.2	-1.2	2.6
S&P/BARRA Growth	552.7	1.4	-0.6	3.6
S&P/BARRA Value	586.3	1.8	6.2	12.4
S&P Energy	278.8	0.0	24.4	41.7
S&P Financials	389.0	2.0	2.4	5.5
S&P REIT	135.6	1.1	17.1	23.2
S&P Transportation	225.0	1.4	11.4	13.1
S&P Utilities	134.3	0.9	13.5	19.2
GSTI Internet	157.8	-0.4	9.0	7.7
PSE Technology	721.9	1.7	3.5	6.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	NOV. 3	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1267.2	3.2	7.5	22.2
London (FT-SE 100)	4718.5	1.9	5.4	8.9
Paris (CAC 40)	3769.9	2.5	6.0	9.6
Frankfurt (DAX)	4039.0	2.8	1.9	7.9
Tokyo (NIKKEI 225)	10,887.8	1.8	2.0	3.1
Hong Kong (Hang Seng)	13,397.7	4.4	6.5	7.7
Toronto (S&P/TSX Composite)	8841.4	0.6	7.5	12.7
Mexico City (IPC)	11,765.8	2.2	33.8	42.8

FUNDAMENTALS

	NOV. 2	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.69%	1.72%	1.62%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.3	19.4	27.3
S&P 500 P/E Ratio (Next 12 mos.)*	15.9	15.5	17.7
First Call Earnings Revision*	-0.27%	-0.51%	0.02%

*First Call Corp.

TECHNICAL INDICATORS

	NOV. 2	WEEK AGO	READING
S&P 500 200-day average	1119.3	1119.4	Positive
Stocks above 200-day average	61.0%	59.0%	Neutral
Options: Put/call ratio	0.69	0.75	Neutral
Insiders: Vickers NYSE Sell/buy ratio	4.20	4.28	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Airlines	15.5	Internet Software	72.9
Fertilizers & Ag. Chems.	15.4	Internet Retail	72.9
Agricultural Products	13.8	Steel	68.8
Food Wholesalers	12.8	Oil & Gas Refining	68.1
Office Electronics	9.7	Fertilizers & Ag. Chems.	66.3

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Insurance Brokers	-36.9	IT Consulting	-35.3
Multi-line Insurers	-10.8	Semiconductor Equip.	-33.1
Automobiles	-8.3	Insurance Brokers	-31.0
Divsfd. Commercial Svcs.	-7.8	Semiconductors	-26.5
Health-Care Supplies	-7.0	Airlines	-20.4

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Real Estate	3.4	Natural Resources	37.5
Europe	2.7	Latin America	32.8
Communications	2.4	Real Estate	27.7
Technology	2.2	Europe	24.5
LAGGARDS		LAGGARDS	
Natural Resources	-3.7	Technology	-4.9
Health	-3.6	Precious Metals	1.5
Precious Metals	-2.5	Small-cap Growth	1.7
Pacific/Asia ex-Japan	-0.9	Large-cap Growth	3.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFds. Intnet. Ultsr. Inv.	12.3	iShares MSCI Austria Idx.	65.2
Berkshire Focus	8.9	ProFunds Energy Ustr. Inv.	62.0
Wells Fgo. Specd. Tech. A	7.8	U.S. Gbl. Accde. E. Eurpn.	51.3
PIMCO RCM Gbl. Tech. D	7.8	State St. Rsch. Gl. Rs. B	51.2
LAGGARDS		LAGGARDS	
ProFds. Phmls. Ustr. Inv.	-9.7	ProFds. Smicdr. Ultsr. Inv.	-42.4
Metzler/Pdn. Eur. Qnt. Eq.	-9.1	GMO Emerg. Mkts. Qty. III	-41.2
ProFds. Hlthcre. Ustr. Inv.	-7.7	Thurlow Growth	-39.5
Firsthand Tech. Value	-7.6	Ameritor Investment	-36.1

INTEREST RATES

KEY RATES	NOV. 3	WEEK AGO	YEAR AGO
Money Market Funds	1.33%	1.30%	0.62%
90-Day Treasury Bills	1.95	1.91	0.95
2-Year Treasury Notes	2.59	2.58	1.93
10-Year Treasury Notes	4.07	4.09	4.35
30-Year Treasury Bonds	4.83	4.85	5.18
30-Year Fixed Mortgage†	5.67	5.58	5.91

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.48%	4.52%
Taxable Equivalent	4.97	6.46
Insured Revenue Bonds	3.67	4.67
Taxable Equivalent	5.24	6.67

THE WEEK AHEAD

INTERNATIONAL TRADE

Wednesday, Nov. 10, 8:30 a.m. EST » The foreign trade deficit probably narrowed to \$53.3 billion in September. That's based on the median forecast of economists surveyed by Action Economics. In August the trade gap hit \$54.1 billion.

EXPORT-IMPORT PRICES

Wednesday, Nov. 10, 8:30 a.m. EST » Export prices most likely grew by 0.3% in October,

following a 0.4% gain in the prior month. Import prices are expected to have surged 1.6% after a 0.2% rise in September. Petroleum prices, which topped \$55 per barrel during October, are the key reason for the expected leap.

FOMC MEETING Wednesday, Nov. 10, 9 a.m. EST » The Federal Reserve Board's Open Market Committee will meet to set monetary policy. Economists queried by Action Economics

expect the Fed will hike rates to 2%, from 1.75% currently.

RETAIL SALES Friday, Nov. 12, 8:30 a.m. EST » October retail sales probably grew 0.2%, after a 0.5% rise in September. Minus vehicles, sales most likely rose by 0.5% in October.

BUSINESS INVENTORIES Friday, Nov. 12, 10 a.m. EST » September inventories probably expanded by 0.5%, following a 0.7% increase in August.

The BusinessWeek production index improved to 229.6 for the week ended Oct. 23, a gain of 12.2% from a year ago. Before calculation of the four-week moving average, the index climbed to 230.5.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

The Companies

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A

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 Adam Opel (GM) **72**
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A Second-Term Agenda for President Bush—and America

CONGRATULATIONS, President Bush, on your strong victory. Not only did you personally win both the popular and electoral college vote but the Republican Party also increased its Senate seats to 55 and boosted its majority in the House of Representatives. So what is next? The stock market anticipates enactment of your platform to make permanent the tax cuts on capital gains, dividends, and income, as well as to keep your promise on tort reform. But the bond and currency markets are flashing concerns about the twin budget and trade deficits. Tough choices lie ahead for you and the nation. Your mandate and your freedom to act—without reelection worries—give you the opportunity to tackle key problems facing America.

Here are some of the issues ahead and our take on them:

THE BOOMERS ARE RETIRING ON YOUR WATCH. Some 70 million baby boomers will soon draw down trillions in government payments. The oldest, born in 1946, will start getting Social Security when they hit 62 in 2008. Three years later, many will join Medicare. You ran on allowing individuals to put 4% or more of their payroll taxes into private accounts. This helps young people build up their nest eggs, but the government has to come up with \$2 trillion to cover its Social Security obligations to the boomers. Your advisers suggest borrowing the money. That's a lot of new debt, especially when the Congressional Budget Office says Social Security isn't in immediate trouble and won't hit empty until 2052. Mr. President, the real crisis ahead is Medicare, which is financially troubled, due in part to the new, poorly designed Medicare drug benefit. Medicare reform should be the higher priority.

THE BUDGET DEFICIT IS OUT OF CONTROL. Squaring your election promises on tax reform with fiscal realities is certain to be one of your major challenges. True tax reform means ending the Alternative Minimum Tax, which is hitting more and more middle-class people. A long-term fix for the AMT would cost \$600 billion over a decade. Your promise to make permanent the income, capital-gains, dividend, and estate tax cuts would cost \$2 trillion over 10 years. Throw in \$2 trillion to set up private Social Security accounts and that's about \$5 trillion. Add that to the current \$2.7 trillion

projected deficit and it comes to \$7.7 trillion of red ink over 10 years. Sooner or later, these numbers will shock the bond market. Choices on taxes have to be made, Mr. President. Keep the pro-growth capital-gains and dividends cuts and simplify the tax code. Get tough with Republican spend-thrifts in Congress by trimming the pork in spending bills for highways, energy, and agriculture while reminding them of core conservative fiscal principles.

THE DOLLAR, AND TRADE POLICY, ARE IN TROUBLE. Early next year, China will start exporting billions of dollars' worth of textiles into the U.S. as global textile quotas end. The trade deficit is already huge, thanks in part to surging oil imports. The current account deficit is at a record high of 5% of gross domestic product. Foreign buyers of U.S. Treasuries, who finance the big federal budget deficit, are getting nervous. The policy of benign neglect on the dollar isn't helping the trade deficit because Beijing links the yuan to the dollar. Something has got to give—the yuan has to go up, the dollar has to drop more, or America's free-trade policy has to radically change. Mr. President, real leadership is needed here.

With a \$7.7 trillion budget deficit looming, it's time to cut spending

MIDEAST POLICY NEEDS A REALITY CHECK. Elections in Afghanistan are a clear win for America. But it's time to get real in Iraq. The idealistic dream of establishing a stable, democratic Iraqi nation looks problematic. Yes, the U.S. will win the battle for Fallujah. But then what? It's time to ask what is the minimally acceptable exit

strategy for the U.S. The pragmatic answer to that is stability in Iraq. A western-style democracy may have to wait. Pragmatism also demands that the U.S. directly engage in nuclear nonproliferation talks with Iran and North Korea. Your first Administration outsourced this job to Europe and China, with little success. The U.S. has to lead the negotiations. It's also time to accept that Muslims view American actions in Iraq through the prism of the Israeli-Palestinian conflict. Mr. President, reengaging as a mediator between the two parties would boost U.S. influence in the Middle East.

SECOND-TERM PRESIDENTS THINK ABOUT THEIR LEGACY. Mr. President, you have a chance to lock in much of your conservative vision. Your boldness is admirable, but hard choices are essential to guarantee your success and the country's well-being.



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ROBERT BERNER (P.144)

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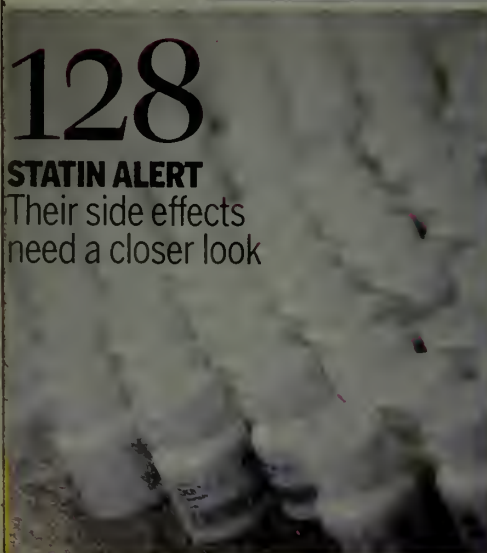
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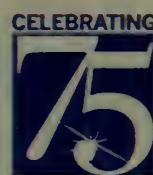
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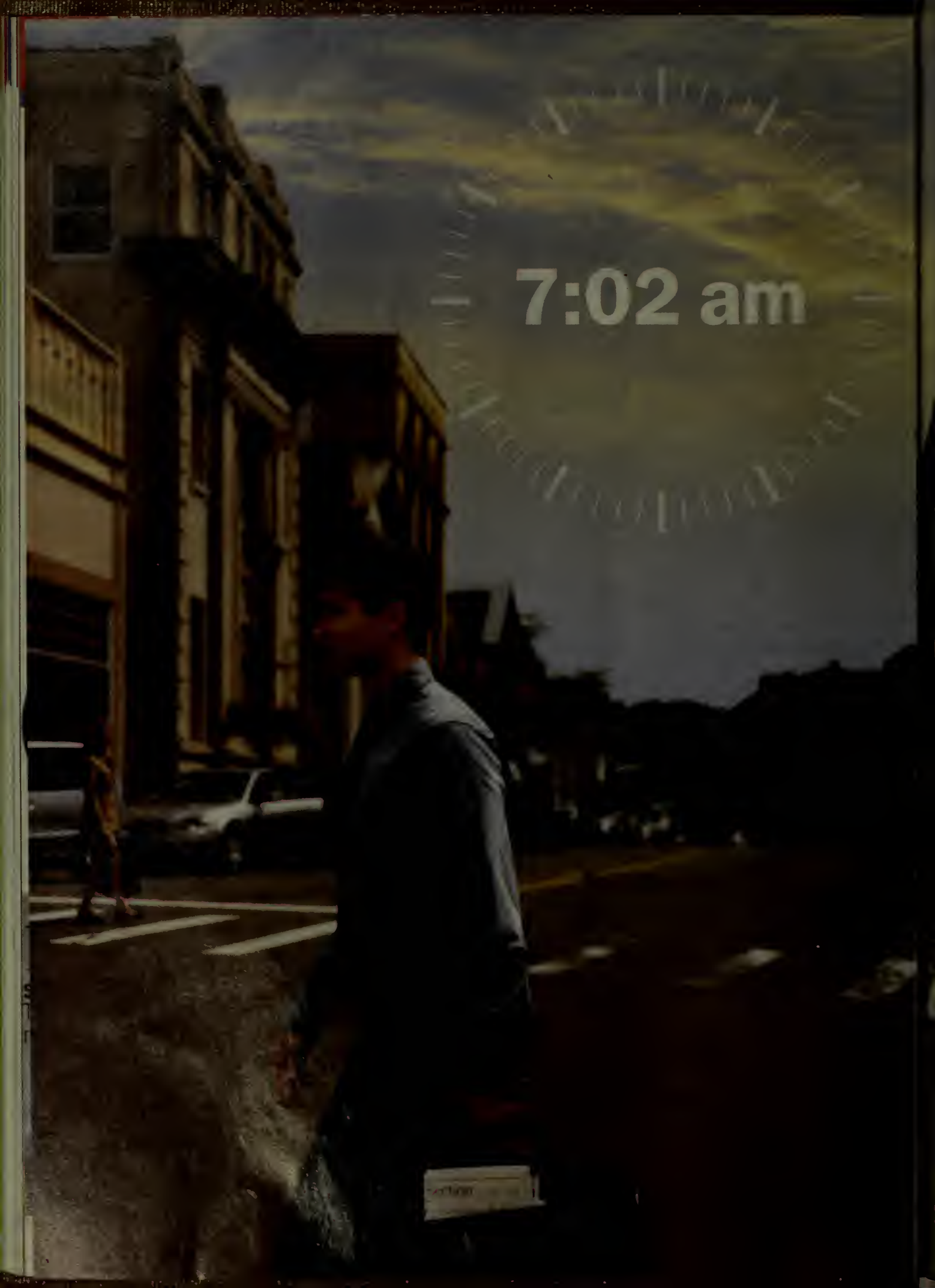
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Gaga for Google: How Much Is Too Much?

Many investors who passed on the IPO are kicking themselves now. The search giant's stock is flying, and not without reason—but at what point does it become overpriced? The answer isn't so simple



Big Brother's Passport to Pry

The U.S. is moving forward with a plan to equip all its passports with RFID chips that can be read surreptitiously from a distance. The government says it will help prevent terrorism. But privacy activists fear the information could be stolen and misused

The U.S. Economic Outlook Keeps Getting Brighter

S&P Chief Economist David Wyss says October's surging employment numbers, mild inflation, and consumers' eager willingness to spend point to a recovery continuing to gain strength



Drug Ads—Without Harmful Side Effects

As the Vioxx debacle shows, pitching medicines directly to consumers has some serious drawbacks. The goal should be to make doctors and patients smarter buyers of drugs. Here are some innovative ways to get information out—safely

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His successors don't have broad enough support among Palestinians to make the hard decisions needed when negotiating with Israel



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"Nobody quantified the total cost of the severance package, and I wish we had."

—Graef Crystal, compensation expert who helped craft ex-Disney CEO Michael Ovitz' contract, which gave him a \$140 million severance after 14 months' work

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AUDIT TRAIL A BOON FOR THE BEAN COUNTERS

TWO YEARS AGO, accounting firms were doing their darnedest to keep Sarbanes-Oxley from becoming law. Luckily for them, they lost:



The measure is turning out to be a boon for bean counters.

Companies are now racing to comply with Section 404 of the Sarbanes-Oxley Act by yearend. The provision requires publicly traded corporations to vouch for

internal financial controls and remedy any problems. A recent survey by **Financial Executives International**, finds that, on average, companies will spend \$3.1 million and 30,700 hours to comply—nearly double estimates in a January poll.

Much of that expense is revenue for privately held accounting firms. Audit fees are expected to jump more than 50% this year, says FEI. To deal with the upsurge, the Big Four are hiring like crazy and logging tons of overtime. **KPMG** has added 850 auditors this year, while

PricewaterhouseCoopers has brought in 400 people from other English-speaking lands as temps. "It's a scramble," says Dennis Nally, PWC's U.S. senior partner. It seems every cloud does have a silver lining.

—Michael Arndt

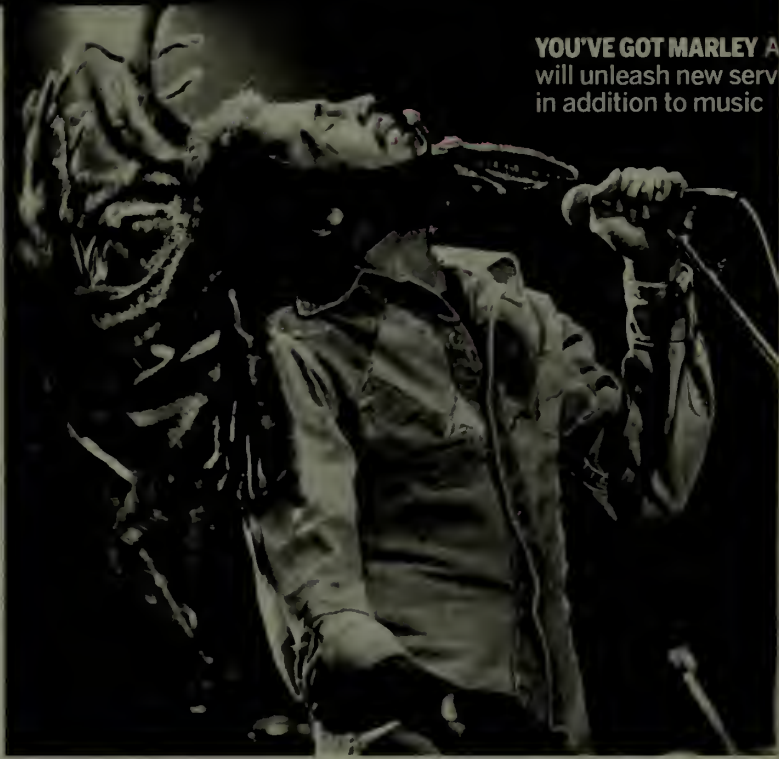
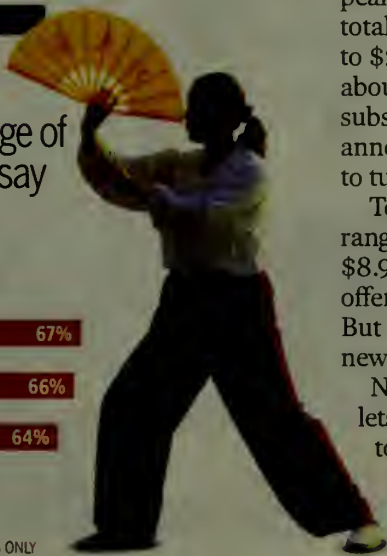
THE BIG PICTURE

OVERBOOKED The percentage of people in these nations who say there's never enough time in the day to get things done:



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will unleash new serv
in addition to music

WIRED WORLD

AOL: Adding On The Add-ons

IT'S NO SECRET that AOL continues to lose subscribers—from a peak of 26.7 million two years ago to 22.7 million today. And total revenues are leveling, growing just 1% in the third quarter, to \$2.1 billion. But the flagging online division of **Time Warner** is about to rev up new services to boost what it makes from each subscriber. *BusinessWeek* has learned that on Nov. 15, AOL will announce that it's teaming with an Irish technology company to turbocharge its add-on premium services.

Today, 3.2 million AOL members buy premium services, ranging from \$1.95-a-month extra password protection to \$8.95-a-month online music subscriptions. Since AOL started offering them two years ago, they number only a half-dozen. But on Nov. 10, AOL broke out premium services as one of four new divisions it's counting on to fuel growth.

Now, with the help of **Valista**, which provides software that lets wireless carriers **NTT DoCoMo** and **Vodafone** sell ring tones to subscribers, AOL will create new offerings faster than the 12 months it often takes. Expect a slew of new ones starting this year, including Web phone-calling, file backup help, and more digital entertainment.

—Catherine Yang

WEB-SPINNING HOMETOWN BROADBAND HEROES

THE BABY BELLS' plans to build speedy fiber-optic networks to reach well-heeled homes across the U.S. sidestep rural states such as Iowa and West Virginia. Now these



communities are helping themselves across the Digital Divide. On Nov. 11, more than 80 Iowa communities will proceed to set up their own municipal utilities to lay fiber that one day could deliver top speeds of 100 megabits per second, even faster than what some Bells envision for their networks. Meanwhile, five West Virginia communities, and soon towns in other rural states, will vote on similar measures.

A nonprofit group, **OpportunityIowa**, is spearheading the effort there. Native Iowan Clark McLeod, once CEO of local phone competitor **McLeodUSA**, founded the \$3.5 million nonprofit in January to give underserved regions a shot at a prosperous broadband-fueled economy. "The great equalizer is the Internet," says McLeod. His pal, H. Brian Thompson, chairman of **Comsat International**, is behind Vienna (Va.)-based nonprofit **iTown Communications**, which is

leading the fiber charge in West Virginia. Thompson is putting his own money into iTown but won't disclose how much.

The duo will face resistance from the Baby Bells and cable operators for their measures, which will need additional funds from municipal bonds. But their networks will be leased to any company that wants to

provide services over those lines—unlike the Bells, which do not have to open their fiber lines to others. "Fiber networks are no longer 'nice to have,' but [are] required to successfully compete," says Thompson. If he and McLeod have

their way, everyone—not just the top half—will get those byways.

—Catherine Yang



WHAT'S NEW IN PUSSYCATS

NO SNEEZES By 2007, if all goes well, Fluffy will be almost perfect. At least that's what Allerca, a Los Angeles startup, hopes as it seeks to breed genetically engineered cats with virtually none of the allergen that makes people sneeze. **The hypoallergenic cats, British Shorthairs, will be modified as embryos, using gene-silencing techniques to cut allergens.** The fetal kittens are then implanted into female cats who carry them to term. No cloning is involved. Allerca has received "hundreds" of \$250 deposits for the \$3,500 sneeze-proof felines. Later it may develop hypoallergenic Persians. Cost: a cool five grand each. At those prices, you might still break out in hives.

—Robert McNatt

DRAWN & QUARTERED





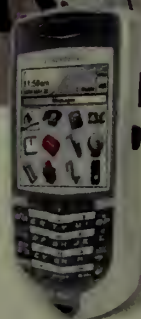
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FACE TIME

JEFF ARNOLD



YOU CAN CALL HIM DR. DVD

When Jeff Arnold founded WebMD in 1998, he predicted the Net would revolutionize health care. Not quite. Now Arnold, who left the then-beleaguered company in 2000, is trying to shake up the entertainment business. On Nov. 12, he hopes to popularize the notion of \$4.99 disposable DVDs that automatically erase after 48 hours. Flexplay, a startup he owns, is releasing *Noel*, an indie movie, to theaters as it goes on sale at Amazon.com and two weeks before it's shown on TNT.

Arnold, 34, aims to be a big gun in digital media. He has amassed a hodgepodge of up-start media assets: He owns N2 Broadband, a provider of video-on-demand services, the encyclopedia Web site HowStuffWorks.com, and LidRock, which distributes music or video-game CDs by snapping them into the plastic lids of sodas sold at theaters and fast-food joints. "We're trying to create distribution, we're procuring content, and we're working with advertisers." It's Round 2 for the tech entrepreneur.

—Heather Green

CONTENT WARS

FILE SHARERS: CAN THEY BE SCARED AWAY?

ON NOV. 4, the Motion Picture Association of America said its members would start suing alleged illegal file sharers. But Hollywood may want to consider whether such legal campaigns have any measurable impact. The Recording Industry Association of America has been suing song swappers since June, 2003, but data on both the suits' effect on file sharing and file sharing's effect on sales are stubbornly inconclusive.

Although music file sharing has gyrated up and down since the suits commenced, BigChampagne, which tracks file-sharing networks for media companies, estimates that the average number of people at any one time on peer-to-peer networks in the U.S. has risen 22% during the past two years. The RIAA points to results from other monitors, such as the Pew



ACTION: Tom Hanks in *The Terminal*, a popular download

Internet & American Life Project and Nielsen//Net-Ratings, that show file sharing is down. But Pew doesn't poll people under 18, a big slice of the file-sharing community. And up-and-coming P2P networks elude Nielsen ratings.

Similarly vexing are studies on file sharing's impact on music sales. MPAA President Dan Glickman contends that movie downloading—still tiny compared with music—will eventually harm DVD sales and box office receipts.

Indeed, Stan Liebowitz, a professor of economics at the University of Texas at Dallas,

says there's a correlation between a 4.5% decline in file sharing during the first half of 2004 and a 3.6% increase in the value of music shipments reported by the RIAA, compared to last year. However, a look at the nine months from January to September by BigChampagne shows a 13.2% hike in file sharing, while market researcher Soundscan reports a 5.9% jump in album sales growth. Liebowitz says he hasn't studied the nine-month data. But for now, the MPAA is firmly in the camp of the RIAA.

—Heather Green

SPORTS BIZ

NO HOCKEY? NO BIG DEAL, EH?

FOR 52 YEARS, *Hockey Night in Canada* has been a Saturday night TV stalwart north of the border. But a National Hockey League lockout has forced the Canadian Broadcasting Corp. to ditch the program in favor of old movies such as *A Bug's Life* and *Legally Blonde*. The shocker: The

lineup gets almost the same audience—up to 1.2 million people each night, keeping it among the top-rated Canadian shows.

While the games help pay for other programs at the public broadcaster, the pain is offset by production savings and continued ad sales. "We're satisfied with the revenue we're generating," says CBC rep Ruth-Ellen Soles. "That doesn't mean we don't miss hockey." But it seems many Canadians are coping just fine.

—Diane Brady



NHL LOCKOUT Play is off the air

THE STAT

10

The number of chief executives who have stepped down as a result of investigations by New York State Attorney General Eliot Spitzer.

Data: Reuters Group PLC

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The Great Innovators

CELEBRATING

75

As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

Thinking out Of the Box

EVER SINCE HE decided to drop out of the University of Texas to run his PC's Limited in 1984, Michael S. Dell has taken full advantage of his rivals' refusal to see him as an innovator. Time and again, executives at giants such as IBM and Compaq Computer Corp. derided his low-tech approach to hawking PCs as

unbecoming a true tech company—until it was too late to respond to his market-transforming ideas.

In the process, this soft-spoken son of a Houston orthodontist has changed the very definition of “innovation” as it relates to the high-tech industry. Before him, innovation was about well-schooled engineers in pricey research and development labs inventing high-margin products and technologies. Dell instead trained his eye on finding the most efficient way to get tech products into the hands of customers. By perfecting a simple credo—cut out the middleman—he turned the computer business on its head. To this day, despite a decade of effort by rivals to emulate his approach, Dell remains the only consistently profitable big PC maker. “Dell remade the PC industry in his image and likeness,” says University of California at San Diego assistant professor Gary Fields. “He defined the terms of competition.”

Not bad for a guy who only made it through one year of college. But Dell has always had a genius for spotting holes in conventional wisdom. At 16, he prospected for customers for his newspaper route by scouring lists of newlyweds and home buyers at the county courthouse, and made \$18,000 that helped buy him a white BMW. By 1983, he had realized that every PC was created with the same readily accessible components, such as Microsoft Corp.'s software and Intel Corp.'s chips. By assembling his own PCs and selling them directly to consumers, he could keep the middleman's cut for himself. “I want to compete with IBM,” the 18-year-old told his father.

It didn't take long for him to live up to the bravado. By 1993,

**Michael Dell's
credo—cut out
the middleman
—turned the
computer
business on
its head**

both IBM and Compaq revamped their business models with low-end PC lines designed to match Dell. Yet even as he continued gaining share in desktop PCs, rivals refused to believe Dell's model would work in selling laptops and servers. Their mistake. Today, Dell is tops in laptops and is closing in on the server crown as well.

That was still prelude for Dell's greatest accomplishment: pioneering, and very nearly perfecting, the art of e-commerce. When Dell became the first PC maker on the Web in 1994, its site offered little more than product and pricing information. Soon Dell had turned the Net into an engine for mass

customization—a perfect extension to Dell's direct-sales approach. By 1999, Dell was the largest seller on the Internet, trumping Amazon.com, eBay, and Yahoo! combined.

Certainly, Dell's influence will only increase. As he approaches his fortieth birthday in February, his company is making headway in using its efficient approach to sell storage gear, printers, and flat-screen TVs. But most amazing of all to his peers is Dell's near egoless management. From the start, he has sought out gray-haired mentors to help show him the way. Most recently, he gave up the CEO title to Kevin B. Rollins, whom he considers a master operating executive. Dell remains chairman and is just as active in the company as ever. That spells years of more pain for his competitors—and more affordable technology for the rest of us. ■

—By Andrew Park



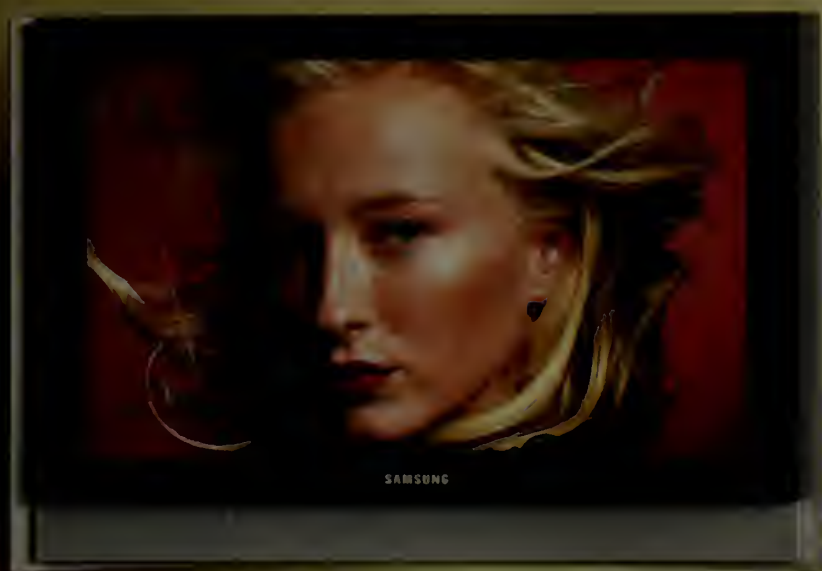
A photograph of two Arsenal football players celebrating on top of a goalpost against a clear blue sky. The player on the left is wearing a white and black kit, while the player on the right is in a red Arsenal kit with the O2 logo. They are holding a large Arsenal flag with a red and white checkered border and the club crest. The goalpost structure is visible in the lower right.

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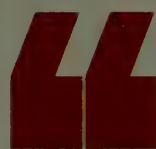
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The McCarran-Ferguson Act of 1945 ... essentially exempted insurance from federal antitrust laws and regulations

—Jerome Gordon
Fairfield, Conn.



WHERE—AND WHEN—INSURERS WENT WRONG

THE CURRENT "JOLTING" investigations spawned by Eliot Spitzer and Richard Blumenthal, attorneys general of New York and Connecticut, and by John Garamendi, insurance commissioner of California, come as no surprise to this former insurance regulator ("The secret world of Marsh Mac" and "A crazy quilt of rules," Cover Story, Nov. 1). Price fixing and side compensation deals for brokers are the result of the lack of cost-based competition. An unregulated oligopolistic insurance-brokerage sector inevitably leads to predator pricing. "Cartelized competition" is what we have in U.S. insurance markets. It is the product of a hoary U.S. law that needs overturning: the McCarran-Ferguson Act of 1945.

McCarran-Ferguson essentially exempted insurance from federal antitrust laws and regulations as "not being in the stream of interstate commerce." State regulatory systems have failed historically to redress these competitive imbalances that deprive insurance consumers of the requisite information to make informed choices. We need federal chartering of insurers akin to our bifurcated state and

federal banking system, coupled with financial examinations equivalent to those of the Office of the Comptroller of the Currency. Canada has had such a system for decades; so could we here in the U.S.

—Jerome Gordon
Fairfield, Conn.

Editor's note: The writer is a retired investment banker and was special assistant to the New Jersey Insurance Commissioner in 1979-81.

AS VICE-PRESIDENT FOR human resources at a large corporation, I worked for 10 years with both Marsh & McLennan Cos. and Mercer Management Consulting at their Minneapolis offices. I found the people I dealt with at both Marsh and Mercer to be top-flight, highly ethical professionals. These same people are now experiencing huge losses as their 401(k) plans and stock options as Marsh stock dropped almost 50% in one day. Their personal pride in working for what they have always considered an ethical company has been severely eroded. Top executives at companies such as this wheel and deal in a world divorced from the realities of what their actions can mean to their rank-and-file employees.

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Readers Report

CORRECTIONS & CLARIFICATIONS

A photo caption accompanying "Team Bush, again...with a few new faces" (Special Report: Election 2004, Nov. 15) misspelled the surname of White House Counsel Alberto R. Gonzales.

ees, and to their customers who have trusted them over the years.

—John P. Oldendorf
Lake Elmo, Minn.

GIVING HOMEOWNERSHIP SOME BIG ASSISTS

IN CASES LIKE THOSE discussed in "When home buying by the poor backfires" (Economics, Nov. 1), our experience working with more than 2,300 communities across the nation tells us that the answer is not to put on the brakes. Studies show that credit and pre-purchase homeownership education and counseling can lower mortgage delinquency rates by up to 34%. Despite these benefits, only 15% of first-time home buyers receive quality training in advance.

Neighborhood Reinvestment Corp. is working to close this growing gap. Our NeighborWorks network has provided counseling to 400,000 families and has assisted more than 75,000 low- and moderate-income home-buying families.

—Kenneth D. Wade, CEO
Neighborhood Reinvestment Corp.
Washington

LOW-INCOME FAMILIES have been denied the stability, prosperity, and economic foundation of homeownership because they lacked the wealth to make a downpayment. In 1997, Nehemiah Corp. created the first downpayment assistance program, essentially standing in place of a giving parent. Since then we have helped more than 180,000 families achieve homeownership and have created an industry that, combined, has helped more than 500,000 families. According to a recent Milken Institute study, these families on average have seen equity gains of more than \$18,000 in the just the first six years—and the gains are still growing. In fact, Nehemiah's first 115,000 gift recipients have already accrued more than \$2.2 billion in home equity. Homeownership creates a new level of financial accessibility and fundamentally alters the economic landscape for generations to come.

—Scott Syphax, President and CEO
Nehemiah Corp.
Sacramento

WHAT ABOUT THE OTHER 98% OF YUCAIPA?

OVER THE PAST 18 YEARS, Yucaipa Cos. has invested several billion dollars in worker-friendly companies and underserved areas, a point that is the key to maintaining our high returns ("Pretty liberal with the cash," Finance, Oct. 18). Most of the companies in which we invest are in retail, logistics, and manufacturing. Yet the article focused on only two of our investments, each representing less than 1% of our portfolio, solely because one involved an entertainment figure and the other the former Vice-President of the U.S. Our investment in Sean John was used largely to build the warehousing and distribution infrastructure for one of the fastest-growing companies in America. The investments in each of these companies was made with the same policies that have given Yucaipa more than 40% internal rate of return for the past 18 years.

—Ron Burkle, Managing Partner
The Yucaipa Cos.
Los Angeles

WHY GOLDEN IS DELICIOUS IN THE BIG APPLE

NEW YORK IS CERTAINLY becoming a more attractive location for retirement ("Spending your golden years in the Big Apple," Personal Business, Nov. 1), and a major reason is New York's extraordinary wealth of cultural assets. Business Volunteers for the Arts, a program operated by the Arts & Business Council Inc. since 1975, matches business people, including those who are retired, as pro bono management consultants with nonprofit arts groups. More information is available at www.artsandbusiness.org.

—Gary P. Steuer, President and CEO
Arts & Business Council Inc.
New York

How to reach BusinessWeek

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His Fists Couldn't Protect Him

UNFORGIVABLE BLACKNESS The Rise and Fall of Jack Johnson
By Geoffrey C. Ward; Knopf; 492pp; \$26.95

The sports world of 1908, the year in which Jack Johnson demolished Tommy Burns to win the heavyweight boxing title, would strike many today as odd and unrecognizable. Babe Ruth was 13. Basketball hadn't turned 20. And the U.S. Open Golf Championship, which teed off for the first time in 1895, didn't attract even 100 entries.

Yet what might seem like an age of innocence was anything but that for black athletes. Outside of the Negro baseball leagues and Johnson's game, prizefighting, black sportsmen had little chance to display their talents. Those who did often felt the fury of a suffocating racial prejudice. John L. Sullivan, the first boxing champ of the gloved era, once famously declared: "I will not fight a Negro. I never have and never shall." Overwhelmingly, America applauded.

Into this world came the defiant, ebullient Johnson. His struggles to cope with racism and overcome his self-destructive impulses are deftly chronicled in *Unforgivable Blackness: The Rise and Fall of Jack Johnson*, an unsettling portrait of the boxing legend and his times. Author Geoffrey C. Ward has written several works of history and is a frequent collaborator with documentarian Ken Burns. This volume is a companion to a soon-to-be-aired Public Broadcasting System film of the same name.

Johnson, though often overlooked by today's boxing fans, deserves a pedestal as lofty as the ones reserved for such champions as Joe Louis and Muhammad Ali. A 79-8 career record in the ring established him as the dominant pugilist of his era. But his true legacy is as the first black heavyweight champ, a distinction earned in his demolition of Burns. That status was affirmed in a 1910 defense against the popular James J. Jeffries, who came out of retirement intending to return the title to White America. Johnson pummeled the ex-champ, winning a technical knockout in 15 rounds.

Ward hasn't unearthed mounds of new information as much as knitted together Johnson's story from published materials. These include Johnson's 1927 autobiography and newspaper accounts of the early century—when no one was making more headlines than he was. Far from a stale rehash, though, *Unforgivable Blackness* is engrossing and, at times, disturbing. Its only flaw is also a strength: a plethora of detail that may overwhelm some readers.

Johnson's personal story is as flamboyant as Ali's and as earthy as Pete Rose's. Born to ex-slaves, Johnson grew up in

Galveston, Tex., yearning for money, possessions, and, above all, attention. Before his death in a car crash in 1946, he had them all. For whomping Jeffries, Johnson earned \$121,000—an amount, Ward surmises, that "may have been larger than any black American had ever earned in a single day before."

Johnson needed such checks to support lavish habits that included a fleet of luxury cars, stays in posh hotels, champagne, and hand-tailored clothes. Arriving in England a year after defeating Jeffries, the champ met the British press attired in one of 20 new suits made for the trip "at a cost of \$3,480—roughly \$64,000 in today's terms." Such ostentation infuriated whites and worried some blacks, who feared the reaction of White America. "The wisest among my race understand that agitation of questions of social equality is the extremest folly," warned Booker T. Washington, the Tuskegee Institute president and prominent black intellectual.

Johnson bowed to no one's idea of proper conduct in a segregated society—except his own. Ward's most compelling storytelling, in fact, deals with the champ's relationships with white women, a challenge to a powerful taboo of the times. Marriage between blacks and whites was outlawed in many states. And the mere sight of a black man in the company of a white woman was a provocation, the author explains.

Yet Johnson's three wives were white, as were many of the call girls he befriended. He and these women were often ostracized from both their worlds. Long Island socialite Etta Duryea never heard from her father again after her 1911 marriage to Johnson, Ward says. Etta killed

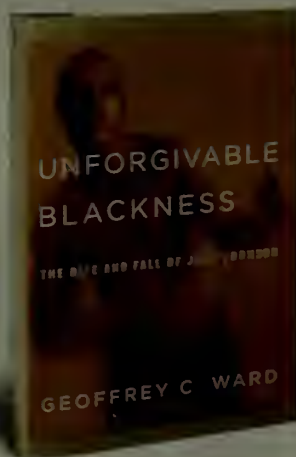
herself a year later, miserable over stories that Johnson was cavorting with other women.

Johnson's bravado resulted in frequent brushes with the law. He bought his way out of most legal troubles. Then, in 1912, he was tried for an alleged violation of the Mann Act, which barred transportation of women across state lines for "immoral purposes." Sentenced

to a year in prison, Johnson fled the U.S. and didn't return for seven years. It marked the end of his high times. Within three years, he had lost his title—in a fight stained by rumor of a fix—and what remained of his fortune.

No doubt bad personal judgment was the cause of many of Johnson's setbacks. But Ward excels at putting such events in the broader context of the times, which were overtly hostile to an ambitious, unapologetic black man. As Ward tells it, that was Jack Johnson. ■

—By Mark Hyman



The first black champ roused the fury of a racist society



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BY STEPHEN H. WILDSTROM

There's Google. Then There's Google Desktop

The logic behind Google Desktop Search is simple enough: Why shouldn't the best tool for finding things on the Web do equally well at helping people search their own computers? The product demonstrates that, as computer scientists have long known, a local search is a world apart from a Web search. It requires different tools and approaches.

Like just about everything Google has done lately, Desktop Search is controversial, with some privacy advocates and competitors warning that the software poses a grave threat. Charges that the new Google product exposes your private searches to the world are grossly exaggerated. The truth is that, while Google does a reasonably good job of finding things on your computer, it presents the results in a way that is not terribly useful.

Bear in mind that Google Desktop Search, available for free download from desktop.google.com, is a "beta," or test, program and will probably remain so for many months. Some of its shortcomings, such as the inability to search the contents of Adobe Acrobat files, will be fixed. But there are fundamental problems in using Google's Web query and results formats for local searches.

GOOGLE'S GREAT STRENGTH IN SEARCHING your PC is the same as in Web searching: It's terrific at finding the copies of Web pages you have visited that Internet Explorer stashes away on your hard drive, including Web-based e-mail such as Hotmail. Enter a search term, and you get back listings that look exactly like Web search results—10 or so items consisting of a title and a couple of lines of extracted text that includes the search term. This is fine for locating the Web page of that hotel in Antigua you looked at six weeks ago, but it's a terrible way to locate the e-mail Aunt Millie sent you last month.

In a local search, you generally know what sort of file you are looking for. So it ought to be easy to restrict the search to e-mail messages, Word files, and the like—but it's not. Most desktop search programs, such as X1, Copernic, or Enfish—as well as the test version of MSN desktop search due from Microsoft by yearend—let you limit the search with a mouse click or two. With Google, you must use geeky filtering commands, such as filetype: e-mail, as part of each search. What's more, the competing tools typically present results in a window with multiple panes—one giving file names, or in



The local search tool is no privacy threat, but it falls short in several ways

you'll get results from both the Web and your PC, and your search terms will obviously be sent to Google. The company insists that the information is not saved and the only ads sent are the sort that accompany every Google search.

Your decision to use Google Desktop Search should be based on whether it meets your needs, not scare talk. If you mostly search for Web pages and use a Web e-mail program it might be just the ticket. But if, like many business users, you need to search a variety of document types and use a mail program such as Microsoft Outlook, you'll probably be happier with a different search tool.

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the case of e-mail, the subject and the sender, and another giving at least a partial view of the contents. Google gives you a thumbnail image of some Web pages, but it is too small to be of much use.

Google Desktop Search is bound to improve before it is officially released. For example, the list of searchable file types will be expanded. And the restriction that keeps more than one person from running searches—on a Windows XP or 2000 computer—will go away.

Despite critics' warnings, Google users need not worry that their desktop queries will be shared with the world, saved in a giant Google database, or used to unleash a flood of ads on their PCs. When you use the Desktop Search form, no keywords leave your computer. If you use the regular Google Web search form

BusinessWeek online For a discussion of the privacy implications of desktop search, go to www.businessweek.com/magazine/extra.htm



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BY ROBERT KUTTNER

The Budget Mess Bush Can No Longer Ignore

Whatever happened to the deficit hawks? As the celebration ends, Republicans should begin to take a hard look at the budget mess and the broader economic calamity that could befall President George W. Bush in his second term. Most of it is of his own making. And with wall-to-wall control of the government since 2002 and four full years since the last

Democratic Administration, the responsibility will be entirely his.

Bush now has the votes to make his tax cuts permanent and to add new ones. The Congressional Budget Office (CBO), which reports to Republican committee chairmen, admits that with realistic assumptions the deficit will total more than \$4.4 trillion by 2014 and not the \$2.2 trillion in official projections. That's because making the 2001 and 2003 tax cuts permanent will cost an additional \$1.65 trillion over 10 years. Preventing the alternative minimum tax from biting the middle class will cost \$603 billion more. Tax simplification could be a net revenue loser, too.

AND IF BUSH SUCCEEDS in partly privatizing Social Security, an additional \$2 trillion will be added to the national debt. Bush will need to borrow money—or raise taxes—both to finance new private retirement accounts and to keep payments flowing to current retirees as he has promised. There is no way for the economy to grow out of deficits of this scale, and at some point they will trigger higher interest rates, slowing growth. The currency markets are already nervous. The dollar fell to a low against the euro on Friday, because foreign investors are looking at the budget and current-account deficits and wondering who is going to finance them.

Administration and CBO projections also assume, optimistically, that federal spending growth will not exceed the rate of inflation. But in Bush's first term, spending growth ran almost double the inflation rate despite cuts in domestic social programs. Although the President is committed in principle to shrinking government, he increased spending for signature initiatives such as No Child Left Behind and prescription-drug subsidies, to the frustration of many conservatives. He also tolerated huge pork barrel outlays. The Iraq war will continue to boost spending. So far most Bush cuts affect mainly the poor, not his constituents. But if he wants to offset tax reductions with additional program cuts, he will have to start curbing big middle-class programs such as Medicare—and voters will notice.

Given low domestic savings rates, budget deficits of this magnitude require foreign financing. For years economists have been warning that the "co-dependency" between the

U.S. and Asian central banks—in which the immense American budget and trade deficits are financed mainly by Japan and China as long as we keep importing their products—cannot be sustained indefinitely. Bush's budget deficits have pushed this arrangement close to a tipping point and a dollar crash. The trade deficit is in excess of 5% of gross domestic product and heading toward 7%. At some degree of U.S. foreign indebtedness, the world will start dumping the dollar and shorting it in the currency markets.

The trade deficits would be smaller if China and Japan ran more open economies. But Bush's heavy dependence on the central banks of these countries undercuts any leverage Washington has to induce them to open further to U.S.

exports and to run more transparent economies. In addition, a weakening dollar scares off non-central bank private foreign investors in American securities. There has been very little private foreign investment in U.S. equities and government bonds lately.

Adding to the trade deficit is the high cost of oil. Despite the recent decline to below \$50 a barrel, Philip K. Verleger of the Institute for International Economics

The U.S. economy can't grow its way out of such big deficits

projects that crude prices will reach \$60 to \$70 within two years. The Administration's energy policy mainly consists of weakened pollution standards and more domestic drilling.

Twelve years ago the business-backed Concord Coalition made a huge difference in fiscal policy. Its campaign for budget balance spotlighted the irresponsibility of the accumulated deficits of Ronald Reagan and George H.W. Bush and added pressure on the new Clinton Administration to get serious about deficit reduction, even at the cost of raising taxes. One hasn't heard much from the coalition lately and even less from business Republicans. ■

Robert Kuttner is co-editor of *The American Prospect* and author of *Everything for Sale*.

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BY JAMES C. COOPER & KATHLEEN MADIGAN

And You Thought the Recovery Was in Trouble

A surprisingly sunny jobs report and easing oil prices will bolster growth

U.S. ECONOMY

Maybe the economy this winter won't be so cold after all. The Labor Dept.'s news that the labor markets generated 337,000 new jobs in October, along with much larger gains in August and September than were reported earlier, suggests consumers are in better shape to withstand higher oil prices and the waning warmth

from tax cuts and lower interest rates. More important, the job data relieve recent worries that the recovery might not be sustainable.

One upshot: More interest-rate hikes by the Federal Reserve are on the way. To no one's surprise, the Fed raised its target rate by a quarter-point, to 2%, on Nov. 10, the fourth such rise in as many meetings. And given the job surge, another quarter-point boost at the Fed's Dec. 14 meeting is likely, after speculation that policymakers would pause during their "measured" pace of tightening. The Fed's Nov. 10 statement offered no hint of a break in its pattern of hiking rates at each meeting. In fact, the Fed sounded slightly more upbeat on the economy and the labor markets than it did after its Sept. 21 meeting.

The outlook is not only benefiting from firmer job markets but also getting a lift from the quick end of the hard-to-predict Presidential election. That relieved some uncertainty over tax policy and economic growth, which had clouded decisions by investors and businesses. The stock market has already shown its approval.

More good news has come from the commodity markets. Crude oil has remained below \$50 per barrel for most of November. And the runup in gasoline prices might well be over, having fallen short of the average \$2.06 peak reached in May. Prices dipped in early November to just over \$2 per gallon, after holding at just over \$2.03 in the previous three weeks. Based on historical patterns, gas prices are about where they should be with crude oil a bit below \$50 per barrel.

To be sure, the economy still faces chill winds. Growth is slowing to a more moderate pace because of the Fed's rate hikes and the lack of new fiscal stimulus. The drag from costlier oil has not been fully felt, especially given fears that heating-oil supplies could be inadequate this winter. And uncertainty still surrounds the U.S. role in Iraq, the federal budget deficit, and the dollar. Nonetheless, stronger labor markets will provide crucial support for future growth.

THE EMPLOYMENT DATA BRIGHTEN the outlook in part because they put an end to the questions about why a healthy economy, which grew consistently above its historical average for six quarters in a row, wasn't

creating many new jobs. Past reports of weak-looking payroll gains also contradicted news that income from wages and salaries was making good headway and that consumer spending remained resilient. Moreover, this year's slowdown in productivity gains was looking like a bad omen for economic growth because it didn't seem as if job increases were taking up the slack. These worries

were only heightened by the press coverage of the contentious Presidential election.

But perceptions can change quickly. Before Labor's Nov. 5 report, job gains seemed to have averaged 101,000 per month since May, when higher gas prices began to eat into consumer demand and to raise caution among



businesses. Now the data show payroll growth in the past five months averaged 171,000, and the monthly pace so far this year is up to 198,000 (chart). That's clearly fast enough to keep up with the growth in the labor force and to ensure unemployment stays on its downward trend begun in June, 2003. The new data also explain why Presidential hopeful John F. Kerry could not gain much political traction on the issue of the economy.

IT'S ALSO CLEAR THAT the September hurricanes substantially depressed that month's job growth. October payrolls got a big boost, as many affected workers returned to their jobs and as post-hurricane reconstruction got under way. Construction employment increased by 71,000 last month, after gains from January to September averaged only 19,000 per month. But even if the post-storm boost to payrolls was more than 100,000 workers, the October advance was impressive, especially since Labor revised August and September payroll gains upward by 113,000 jobs.

The one disappointment in October's job data was the second monthly loss of manufacturing jobs. Factory

payrolls shrank by 14,000 in September and by an additional 5,000 in October. Plus, there was a second straight decline in the factory workweek.

That combination suggests some paralysis on the part of manufacturers—perhaps reflecting concerns about how higher energy costs will affect demand this winter. In recent months many businesses also have shown increased reluctance to build inventories, a pattern that has taken some of the steam out of factory orders and production. However, strong hiring outside of manufacturing assures solid income growth in coming months that will support overall demand.

INDEED, LABOR MARKETS are tightening up at a smart enough pace to generate faster growth in hourly pay. Average hourly earnings of production and nonsupervisory workers rose 0.3% in October from September, and the growth from a year ago has accelerated, from 1.6% earlier this year to 2.6% in October (chart). Over the past six months the annual rate is running at 3.1%.

Pay gains are once again outpacing inflation. That helps explain why consumer spending got off to such a good start this quarter. In October retailers said their same-store sales grew, on average, 4% from a year ago. Car sales, which were expected to fall off sharply from September's incentive-boosted annual rate of 17.5 million vehicles, held up at a strong 16.9 million pace.

The faster growth in jobs also confirms that this year's smaller productivity gains are just following the slowdown trend that occurs when economic recoveries

gain traction. Output per hour among nonfarm businesses grew at only a 1.9% annual rate from the second quarter to the third. Based on historical patterns, that's not a bad showing, but it's far below the 4.5% quarterly average racked up over the previous two years.

Productivity will moderate further in the coming year.



Unlike earlier in the recovery, when demand was growing much more slowly, businesses need to hire more workers to fill orders and boost output. In the first seven quarters of the recovery, companies were able to lift output by 4% annually while cutting jobs and hours by 0.8%. Over the past year, companies have boosted

their output by 4.6%, but jobs and hours grew 1.5%. Primarily as a result of that swing in labor input, productivity growth has slowed, from 4.8% in the first period to 3.1% in the past year.

The dip in productivity growth holds both good news and bad. For corporations, it means tighter profit margins and slower earnings growth. But for workers, as the October job numbers show, it means new jobs and better wages. In the end, this shift toward more labor income will matter more for a sustainable recovery. ■

GERMANY

A Rising Euro Hobbles Growth

FOR MUCH OF 2004, Germany, the euro zone's largest economy, has seen a split between solid export gains and slow domestic demand. Heading into 2005, German consumers will very likely continue to wrestle with high fuel prices and weak labor markets. Now, however, export growth is also at risk, due to a rising euro.

The latest data show that the German economy has slowed in the second half. Growth in real gross domestic product was weak in the third quarter, and the monthly numbers suggest the fourth quarter will also disappoint. The purchasing managers' index in October fell by more than expected, with lower readings on output, new orders, and

export demand. The ZEW index of business expectations in November fell for the fourth month in a row, to 13.9, its lowest level in two years.

For consumers, the labor markets remain a major concern. The number of jobless rose 12,000 in September, and the unemployment rate stayed at a 5½-year peak of 10.7%. High energy prices are another drag on household spending. Retail sales fell in two of

the three months of the third quarter, and October sales are expected to be down as well when the official data are released in early December.

In the meantime, expectations for export growth are dimming because of the record surge in the euro. In

September exports rose by 1.2%, but that followed a 1.6% decline in August. Since May the euro has jumped some 9%, to a rate of \$1.29 to the euro. At the same time, higher oil prices have curtailed global growth, which is weakening demand for German goods. An exchange rate above \$1.30 to the euro is seen as especially troubling, but the level looks inevitable given that the U.S. has done little to narrow its current account deficit and given recent statements from the European Central Bank, which suggest it could hike rates in early 2005.

On Nov. 2, the International Monetary Fund cut its 2005 forecast for growth in Germany. The IMF now expects German real GDP to grow 1.5%, instead of the 1.8% projected earlier this year. If brought to fruition the IMF forecast would put Germany dead last in growth among the 12 members of the euro zone. ■



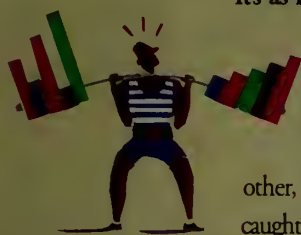


Huw van Steenis, Head of European Diversified Financials Research

Fast lane. Slow lane.

Whatever happened to investing the speed limit?

Traditional “core” fund management is under siege, and the prospects for the middling mainstream look far from appealing. Quantitative specialists offering cheap and effective ways to track market indices are increasingly encroaching on active management, particularly with their enhanced products. Meanwhile, higher-risk specialists who offer spicy investment strategies are winning business from investors lured by the prospects of mouth-watering returns.



It's as if the industry is developing into a **barbell shape**, with the weight of money shifting outward to the index trackers at one end and the high-risk/high-return specialists at the other, leaving less opportunity for those caught in the middle.

Nowhere is this clearer than in the UK pension market, Europe's largest. Over the past few years, large balanced mandates combining equities and fixed income – the staple of the core fund managers – have been chopped up and handed out to index trackers and specialist active fund managers. We estimate that between 1999 and 2004, the three largest core managers lost roughly 10% of their market share in UK segregated funds because of their historical focus on balanced mandates.

But this is not just an Anglo-American phenomenon – the barbell trend is taking hold across continental Europe. For instance, half of the European equity mandates handed out by the French government's €16 billion Reserve Fund have been put into index-tracking strategies. Likewise, there is much European enthusiasm for hedge funds, private equity, structured products, and other specialist mandates. Swiss private banks are recommending at least 10-20% allocations to a range of alternative investments, helping to fuel an estimated 50% growth in hedge fund-of-funds over the last two years.

If the present looks bad for the middling core fund managers, the future looks worse. Pension funds and their advisers are increasingly trying to meet their obligations with a palette of index funds, derivatives, and high-risk/high-return products. Some global pension fund advisers have essentially stopped awarding classic core mandates – the “benchmark plus 1%” – as clients demand cheaper, risk-controlled investing instead.

And a fluid regulatory environment will add to the traditional firm's predicament. Regulatory reviews are acting as a catalyst to drive greater transparency across all fees and practices. This will put additional pressure on managers to demonstrate value for money.

So what will clients demand of core fund managers? Certainly, managers will have to tune up their investment engines to craft higher-performance products and focus more on their clients' evolving needs by creating novel solutions to help them meet their obligations. Also, they will need to keep a strong handle on cost and risk management. Those firms that can combine the investment focus of a boutique with the scale and wider expertise of a larger firm will be in hot demand.



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Head of European Diversified Financials Research

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THE SUPREME COURT

WHAT THE NEW COURT WILL LOOK LIKE

Bush's model is Antonin Scalia. But nominees who share the justice's strict "textualist" approach could set off a firestorm of opposition

WITH BARELY A pause for breath after his hard-fought Election Day victory, President George W. Bush is gearing up for his next big campaign: The fight for the future of the Supreme Court. In his second term, Bush could have the chance to replace as many as four of the nine justices on the nation's highest bench, including the ailing Chief Justice, William H. Rehnquist. No President since Richard M. Nixon has appointed four justices, and, like his, Bush's choices will shape the law and life of the nation for generations.

Court appointments didn't get much attention in the campaign. Yet Rehnquist's late-October announcement that he is undergoing treatment for thyroid

cancer has thrust the issue to the fore of the Administration's agenda. Bush's appointments are certain to move the court firmly to the right. The President has vowed that his nominee will be "somebody who knows the difference between personal opinion and the strict interpretation of the law." In other words, someone a lot like Justice Antonin Scalia—the nation's leading champion of a conservative legal philosophy that is gaining adherents on the federal bench.

Bush has said that Scalia and his ideological soul mate, Justice Clarence Thomas, are his favorites on the court. That is fueling speculation that one of them will be tapped to become Chief Justice when Rehnquist, who has been absent from arguments so far this term, retires. Yet several other names could make the President's short list. Jurists J. Michael Luttig and J. Harvie Wilkinson III, both of

the Fourth Circuit Court of Appeals in Richmond, Va., are among the candidates Bush is rumored to like; Judge Samuel A. Alito Jr. of the Third Circuit Court in Newark, N.J., is running closely behind. All share an adherence, in some fashion, to Scalia's approach to jurisprudence. Indeed, Alito so closely emulates Scalia that he has earned the nickname "Scalito" among liberals.

Count on especially fierce opposition if Scalia is elevated to Chief Justice—or if a Scalia disciple such as Alito is nominated to fill a vacancy. "Scalia is the far-right anchor of the court," says Nan Aron, president of the liberal umbrella group Alliance for Justice. "He is a leader in urging resumption of states' rights, the death penalty, and a ban on gay marriage." While other jurists, including Thomas, are just as conservative, Scalia combines intellectual firepower with per-

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PRAYING FOR CHANGE
Anti-abortion activists
on the anniversary of
Roe v. Wade

suasive charm. Just as important, the 68-year-old justice hews to a philosophical framework—known as textualism—that gives great weight to the written words of the Constitution and legislation. The doctrine's impact: It curbs the power of the judicial branch to create new rights or extend old ones in light of changing social circumstances. For many Democrats, that makes Scalia the embodiment of a dangerously conservative judicial movement that seeks to limit affirmative action, weaken environmental regulations, and curb civil liberties.

That's why both sides are girding for a huge fight. If Bush decides to elevate Scalia or Thomas to Chief Justice as well as name a new justice, he would trigger two confirmation battles in the closely divided Senate. Liberals say they fear having to fight two appointments at once, and conservatives fret that the fallout from such a pitched battle will damage Bush's chances on later appointments. Both sides may urge the President to minimize the firestorm by giving the gavel to an outsider.

"NUCLEAR OPTION"

WITH A 55-44-1 MAJORITY in the Senate, Republicans may try to defang Democrats' opposition to high court nominees. Senate Majority Leader Bill Frist (R-Tenn.) is considering a move to change Senate rules to bar a 40-senator minority from filibustering judicial appointments. If Frist follows through, Democrats vow to bring the chamber to a standstill, blocking even routine business. It's little wonder that Hill aides refer to the possible rule change as the "nuclear option."

Yet the focal point of the seething debate between Right and Left remains Scalia himself. A powerful writer and earthy wit who counts many liberal lawyers among his close friends, Scalia also is ego-driven, divisive, contemptuous of Washington's fixation on conflicts of interest, and prone to controversy. His poison pen—dripping with unconcealed disdain for jurists who lack his intellectual consistency—has limited his ability to bring his current colleagues around to his point of view. But that won't be a problem if Bush taps the growing ranks of like-minded judges to fill vacancies.

Scalia's doctrine: Judges who interpret the Constitution should rely on the docu-



The Scalia Doctrine

Justice Scalia believes that judges should strictly interpret the Constitution, unlike the dominant "legal realist" school that often takes political or cultural realities into account.

PUNITIVE DAMAGES In *State Farm Mutual Auto. Ins. Co. v. Campbell*, the court issued a business-friendly ruling that a huge punitive-damage award violated due process. Scalia disagreed, finding nothing in the Constitution to limit excessive damages.

FREE SPEECH Scalia cast the deciding vote in *Texas v. Johnson*, which overturned a ban on flag burning, angering conservatives. He joined a majority that called the activity "overtly political" speech protected by the First Amendment, even if it incited violence.

CIVIL LIBERTIES Scalia joined liberal Justice John Paul Stevens to condemn an Executive Branch power grab in *Hamdi v. Rumsfeld*, an enemy-combatant case. Scalia's sharp dissent accused the court's plurality, which sought a balance between national security and individual liberty, of trampling individual rights.

PRIVACY The majority in *Lawrence v. Texas*, a case involving state sodomy laws, found a fundamental right to privacy. Scalia criticized the opinion as an "invention of a brand-new 'constitutional right' by a court that is impatient with democratic change."

ABORTION Like many conservatives, Scalia believes there is nothing in the Constitution to support 1973's *Roe v. Wade* decision. He says the issue is purely political and should be left to the states.

ment's actual words regardless of political or cultural concerns that have arisen since the 18th century. Scalia championed the movement in response to a decades-long trend toward a more pragmatic approach to jurisprudence in which judges take current social realities into account as they consider cases. This approach—sometimes known as legal realism—led to such landmark decisions as the Supreme Court's 1973 *Roe v. Wade* ruling, which struck down state prohibitions on abortion. The court's ruling was based on a right to privacy that Scalia rejects because it isn't explicitly spelled out in the Constitution. Scalia believes such decisions should be left to the legislature while judges stick to the written law. Any Scalia disciples Bush names to the high court can be expected to protect property rights, expand the freedom of commercial

OUTSPOKEN
His opinions often skewer fellow justices

and political speech oppose affirmative action, and curb the power of Congress.

But textualism doesn't always lead to conservative results. Scalia hews strictly to his philosophy, which occasionally allies him with the high court's liberal members and against the interests of traditional conservative constituencies, including business. Scalia consistently has defended rights he believes are explicit in the Constitution, even when

he finds them personally abhorrent. In 1989 he cast the deciding vote in a Supreme Court opinion that found flag-burning a form of speech protected under the First Amendment. And his reading of the Fourth Amendment's prohibition on unreasonable searches and seizures led him to break from the majority—and ally himself with liberal Justice John Paul Stevens—when it upheld a mandatory drug-testing program for U.S. Customs employees in 1989.

Even Presidents aren't immune from Scalia's strict reading of the Constitution. In *Hamdi v. Rumsfeld*, the court was asked to consider whether Bush had the power to hold a U.S. citizen seized in Afghanistan as an enemy combatant in detention at Guantanamo. Scalia again joined with Stevens to reject that Executive Branch grab for wartime power. And in *State Farm Mutual Auto. Ins. Co. v.*

Campbell, Scalia broke with Corporate America in a dissent that found no constitutional protection against punitive damages. Scalia and jurists like him "won't be rubber-stamping the conservative or business agenda," says Kenneth W. Starr, a partner at law firm Kirkland & Ellis in Washington and former Whitewater special prosecutor during the Clinton Administration.

Liberals don't buy that, which is why the fireworks over the Supreme Court could dazzle Washington for months. Yet this is hardly the typical D.C. political drama—because once the noise and sparks settle down, the question will remain: More than two centuries after the Constitution was first penned, just how far should the courts go in interpreting the Founding Fathers' words? ■

—By Lorraine Woellert in Washington

BY RICHARD S. DUNHAM AND HOWARD GLECKMAN

Can the GOP Get Down to Business?

The Religious Right wants action on social issues that could distract Congress

ON NOV. 3 MANY of America's corporate chieftains cheered the reelection of George W. Bush, knowing they could look forward to four more business-friendly years of Republican rule. With Bush safely ensconced in the White House and the GOP boosting its margin in Congress, big items on business' wish list seemed within reach: tort reform, permanent tax cuts, continued regulatory relief, a comprehensive energy bill, and private Social Security investment accounts. The election was nothing but "good news for business," exults Chet Helck, president and chief operating officer of Raymond James Financial Ltd., a St. Petersburg brokerage.

If only it were that simple. With the Religious Right calling in Bush Administration chits and with both parties promising to wage war over judicial nominations, some of the joy is ebbing out of those corner offices. Looming on the horizon is a new round in the culture wars, sparked by protracted and bitter fights over appointment of judges, abortion rights, and gay marriage. Hashing out those conflicts could render Congress a barren battleground, stalling progress on a bottom-line business agenda that has traditionally steered clear of divisive social issues.

Little wonder that some executives worry that their economic priorities could be sidetracked by a resurgent Religious Right. "I don't see the Republican win as an open invitation to drive every issue that the [cultural conservative] groups found important right through the doors," says Kendig Kneen, chief executive officer of machinery maker Al-jon Inc. in Ottumwa, Iowa. "Abortion can do a pretty quick job of dividing up Congress and diverting them [from economic issues]." Business leaders, adds Stanton D. Anderson, executive vice-president of the U.S. Chamber of Commerce,

"just want to steer clear of [the culture wars] altogether and stick to business."

It's the height of irony for a Corporate America that opened its hearts and wallets to Republicans in Election '04. Despite unprecedented business fund-raising and get-out-the-vote efforts on Bush's behalf, leaders of the Religious Right contend that, by turning out an additional 4 million of their faithful, they assured Bush's victory and now deserve a spot at the head of the table. "The Republicans are in power because the evangelicals and social conservatives voted them into power," says Christian Broadcasting Network Chairman Pat Robertson, who started the Religious Right mobilization with his own 1988 Presidential campaign. "If the Republicans falter, they will lose big-time down the road."

To make sure that doesn't happen, Christian conservatives are already pressuring a reelected Bush to emphasize the moral agenda they favor. The priorities: naming strict constructionists to the Supreme Court and other federal judgeships; further restricting abortion until the Bush nominees can overturn *Roe v. Wade*; outlawing gay marriage; banning human



Bush II: The Business Agenda

TORT REFORM It's a top priority for the President, as well as for businesses large and small. Congress is poised to pass limits on class actions and is working to limit medical malpractice claims and asbestos liability.

SOCIAL SECURITY PRIVATE ACCOUNTS The White House wants to allow workers to invest part of their Social Security payroll taxes in the stock and bond markets. If created, such private accounts could boost Wall Street and provide billions in new investment capital for Corporate America.

TAXES Small business, in particular, wants Bush to move quickly to make the 2001-03 tax cuts permanent. He'll also name a commission to get started on a long-term plan to overhaul the progressive income tax—even though business, fearful it will have to pick up the tab, is lukewarm.

REGULATORY RELIEF Companies want less intrusive rules and less paperwork. The President will push government agencies to reduce the red tape he claims is holding back employment growth. Among the targets: workplace safety regulations, environmental rules, and wage-and-hour laws.

ENERGY Most execs would like to see energy prices stabilize—and eventually fall. Convinced this will happen with stepped-up drilling and conservation, they want Bush to push again for passage of legislation that would open up more public land to drilling and offer new incentives to producers.

cloning; diverting more federal funding to "faith-based" social programs that are administered by church groups; and taking on Hollywood and other purveyors of American popular culture over what they perceive as rampant sexuality and glorified violence.

On a Crusade

WHAT'S MORE, the new social crusaders are eager to test their political clout. One early target is Pennsylvania Senator Arlen Specter, a pro-choice Republican who is in line to become Judiciary Committee Chairman. Religious conservatives, furious with Specter for suggesting that anti-abortion judges might not be able to win Senate confirmation, have launched a campaign to deny him the gavel, flooding Capitol Hill with telephone calls and e-mail messages.

One early target is GOP Senator Arlen Specter

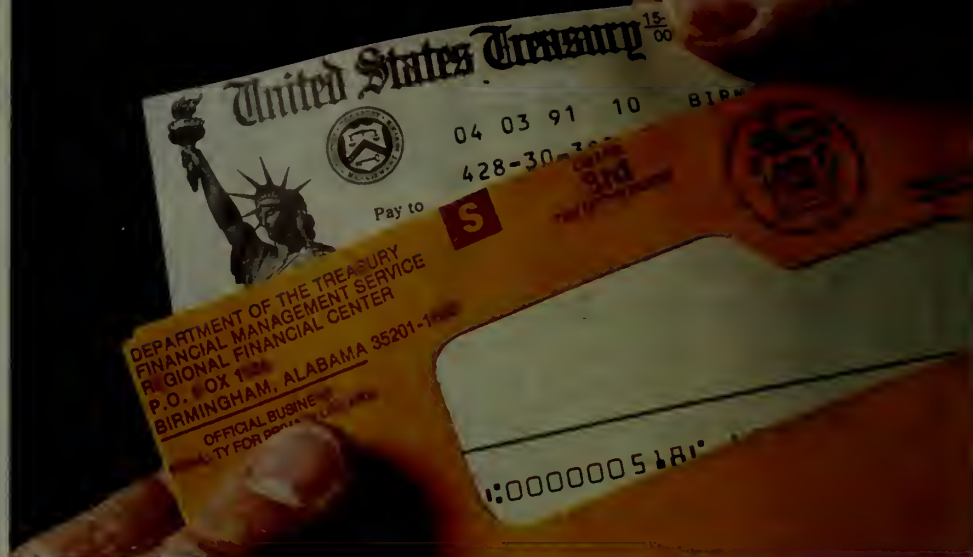
While corporate lobbyists have worked closely with Specter on crafting asbestos-liability legislation and on other business matters, they're not inclined to defend him from the Religious Right. If Specter becomes the first post-election casualty of the culture wars, it could delay a key element of tort reform. And it would make a lot of chief executives nervous that, in the coming battle over the courts, their economic priorities could suffer from collateral damage.

Yet even if social issues don't sidetrack the business agenda, there are other potential problems ahead. Despite the 10-vote Republican edge in the Senate, the GOP still falls five votes short of the 60 necessary to shut down Democratic filibusters. That means Republican senators can't make headway on many of their bills without a few compromises with Democrats on issues such as tort reform and energy legislation.

White House officials insist there is plenty of room in the GOP's Big Tent for cultural and economic conservatives, and they see no conflict between their priorities. Social conservatives "are not due any special claim or privilege," says White House counselor Karl Rove. Anxious CEOs can only hope that Rove is as right about that as he was with his election prediction. ■

—With Lorraine Woellert
and Paul Magnusson

THE HARSH TRUTH
Benefits eventually
will have to be cut
or taxes raised



RETIREMENT

WHAT'S AHEAD FOR SOCIAL SECURITY

Can Bush's proposed private accounts fix the system's fiscal troubles?

PRESIDENT GEORGE W. BUSH has interpreted his reelection as a mandate to restructure the troubled Social Security system. While Bush has not yet said how he'd do it, he has called for sweeping changes that would divert part of workers' payroll taxes into individual investment accounts. His goals: heading off a fiscal collapse of Social Security and promoting an "ownership society" that would give working Americans a chance to build their own retirement stake of stocks and bonds. Here's how today's system works and how Bush may change it:

How does Social Security really operate?

Social Security functions on a pay-as-you-go basis: Current workers' taxes pay for current retirees' benefits. The 12.4% payroll tax—split equally between workers and employers—raised \$632 billion in 2003; \$471 billion went right back into benefits. The rest was spent on programs ranging from the war in Iraq to restoring national parks.

I thought it went into a trust fund.

The Social Security Trust Fund is a carefully tended myth. There is no trust fund—just a great big file drawer full of Uncle Sam's promises to pay benefits. Around the year 2018 annual payouts will start to exceed annual revenues. And by around 2042 the system as it exists will no longer be able to pay all promised benefits.

How big will the shortfall be?

If Washington waits until 2042 to act, revenues will cover only an average 70% of promised benefits in the decades that follow. Take a boy who was born in 2000 and makes the median income over his working life. He will be promised \$290,900 in today's dollars. But the system will only have the resources to pay him \$208,900.

Why such a gloomy outlook?

Demographics. Pay-as-you-go Social Security only functions if there are enough workers to support each retiree. Today there are 3.4 workers per pensioner. In 30 years there will be only two.

Won't faster economic growth fix this problem?

That's wishful thinking. Stronger growth is fueled by rising productivity, which eventually boosts wages. But each retiree's initial benefit is pegged to those wages. So while faster growth raises payroll tax revenues, it also drives up benefits. The gap never closes.

Can private accounts get us out of this mess?

Many conservatives think so. They argue that by diverting payroll taxes into such accounts, workers and the system could win big. Today promised benefits work out to about a 2% annual return on payroll taxes. The same funds invested in a balanced portfolio of stocks and bonds might earn 5%.

Sounds good to me.

It sounds good to President Bush, too. The White House has not yet endorsed a specific proposal. But outside economists who favor the concept say the accounts could range in size from 2% of wages to the full 6.2% a worker now shells out in payroll taxes. Unlike today's system, the funds in those accounts would belong to you and could be passed on to your heirs.

How would the accounts work?

Any worker under, say, 50 or 55 could establish an account, although they would be voluntary. Investments would most

likely be limited to a handful of choices such as stock-index mutual funds, bond funds, and cash. Upon retirement, the accounts would be turned into annuities that pay out a fixed amount each month. In most plans, money would be managed by Wall Street firms. And that has critics worrying about whether fees would eat up benefits, as they have with so many 401(k) plans.

Wouldn't market investments increase risk?

Private accounts would generate greater potential returns by investing in stocks and bonds, but they'd also be riskier.

If the money were poorly invested or withdrawn in a bear market, some workers could end up with less retirement income than if they had stuck with the basic government benefit.

Any other catches?

The biggest is the cost of moving from the existing system. If workers shift, say, 2 points of payroll tax into their accounts, the government would have to find some other money to pay benefits to current retirees. The transition cost:

at least \$1 trillion over the next decade. If workers shift more into private accounts, costs could approach \$2 trillion.

At the moment it looks as though the Administration is leaning toward having Uncle Sam borrow the money to fund the transition. Unfortunately, the feds are already borrowing \$400 billion a year to finance the deficit. Shifting to private accounts would add \$100 billion to \$200 billion a year to that debt.

Forever?

No. The accounts eventually would build up enough assets so that their owners would enjoy annual income exceeding what they would get under today's system. Moreover, supporters argue, borrowing now merely prefunds future Social Security obligations that Washington must eventually finance anyway. Thus, in the long run, the accounts should cost the government less and reduce its borrowing needs. But de-

pending on the accounts' structure, that outcome could be decades away.

It is hard to know how either the public or the bond market will respond to such a complex financing arrangement. Mark Zandi, chief economist of Economy.com, figures it would raise Treasury rates by 0.2%, but critics fear the price could be far higher.

What would happen to benefits?

The President has not explicitly said. But nearly all economists acknowledge that the basic government-paid benefit for those who invest in the accounts will have to be cut. That might mean reducing cost-

of-living increases or raising the retirement age for workers under, say, 50. But that would be political dynamite—Democrats are certain to attack any benefit cuts. Still, private accounts or no, benefits eventually will have to be reduced or taxes raised.

What would happen to current retirees?

Nothing. Despite dire predictions by Democrats, no one is proposing cutting benefits for them. No matter what happens, they

are untouchable.

Are private accounts the only solution to the Social Security problem?

No. If all you want to do is make the system solvent so Washington will have the resources to pay future benefits, you could make far more modest changes. Some ideas: trim cost-of-living increases so they more closely track actual inflation; reduce benefits slightly for those who were high earners; boost the retirement age to better reflect life expectancy; or raise the amount of wage income subject to the payroll tax.

So why create private accounts?

To borrow a word being used a lot these days, think of it as a values issue. Should the government provide workers with a basic, though fairly modest, benefit in retirement? Or should workers have the opportunity to build their own nest egg—a chance that comes with a shot at a more comfortable retirement but also the risk that their investments will come up short? With a program as important as Social Security, the issues are far bigger than just dollars and cents. ■

—By Howard Gleckman, with Mike McNamee, in Washington

THE STAT

\$1-2 Trillion

Funding needed to pay for a transition to private Social Security accounts

Data: Office of the Actuary, Social Security Administration

GOING NEGATIVE



THE ECONOMY

RAISING RED FLAGS ABOUT PRODUCTIVITY

Why some Fed policymakers are asking how long the efficiency miracle can last

IT HAS PRACTICALLY BEEN AN ARTICLE of faith at the Federal Reserve: Fueled by the Information Revolution, strong productivity growth is here to stay. Indeed, Fed policymakers once again called the underlying growth rate of productivity "robust" as they bumped up interest rates for the fourth time this year on Nov. 10.

But behind the scenes, some Fed policymakers are questioning how much longer the efficiency miracle can go on. They see signs of a slowdown in the torrid pace of technological innovation in the computer and chip industries, advances that have propelled productivity in the last decade. And they wonder if those are a harbinger of less vigorous gains ahead.

After clocking in at a rapid rate of 4.4% in both 2002 and 2003, nonfarm productivity growth slowed to 1.9% in the third quarter. And judging by the 337,000 rise in payrolls in October, it could decelerate further in the fourth, perhaps to as low as a half percent, according to consultants Macroeconomic Advisers LLC.

What's critical is whether this slowdown is symptomatic of a permanent downshift. Most experts aren't too concerned. They see it as only a temporary response to the ups and downs of the business cycle and point to a host of innovations in the tech industry. Indeed, they peg the underlying growth rate of productivity at 2½% or better.

So what exactly is making some Fed worrywarts antsy? Their concerns have been triggered by changing pricing patterns in tech. Between 1992 and 2002, the quality-adjusted



EASING UP?



price of new computers as compiled by the government fell at an annual rate of 18%. Those sharp dips mainly reflected the pace of technological progress and faster productivity growth. The rapid improvements in technology spurred stepped-up computer buying by businesses, spreading the productivity miracle throughout the economy.

But recently the pace of the price drops has moderated. In 2003 and into '04, computer prices fell at an annual 9% rate. At the same time, business purchases of

computers have slowed. "One possible explanation is that we are seeing a deceleration in the pace of technical advancement," Fed Vice-Chairman Roger W. Ferguson Jr. said in an Oct. 26 speech.

Another crunch sign that Ferguson cites: a slowdown in the introduction of PC models. Computer makers roll out models to exploit the latest technological advances in chip speeds. If the pace of such innovation is slowing, there's less need for new computer designs. Data used by the Fed for its industrial production statistics shows that the number of PC models unveiled this year has dropped, perhaps by 10% to 20%.

In sorting out what's going on, some Fed officials point to Intel Corp.'s recent admission that it plan for making microprocessors cheaper and faster hit a wall because its latest generation of chips is too hot to cool efficiently. Intel is shifting to a multiple-core production process that combines processors on one chip.

DIFFERENT MEASURES

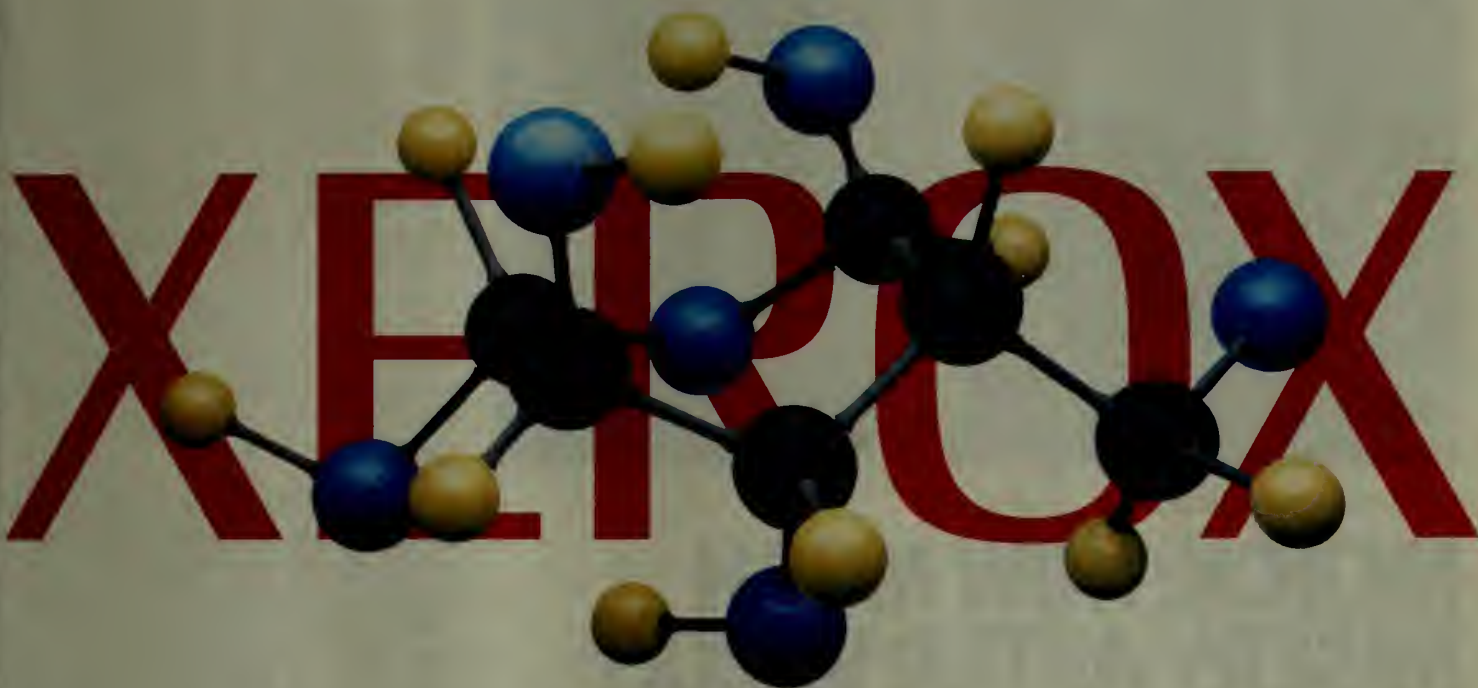
TO BE SURE, most Fed policymakers, including Chairman Alan Greenspan, are upbeat about the long-term outlook. More important, tech insiders are, too. They say Intel's woes are of its own making and note that Advanced Micro Devices Inc. is well ahead of its rival in rolling out the multicore chips that may become the industry standard.

What's more, tech execs say that they see no signs of a letup of productivity-enhancing innovation elsewhere in the industry that's not necessarily being

picked up by government statisticians. Those areas include open-source software as well as wireless and Internet telephony. Amazon.com Inc. CEO Jeffrey P. Bezos says that disk space and bandwidth costs are dropping by 50% every 12 months, permitting the e-tailer to store ever more content and deliver ever more Web pages to its customers. And like many companies, Amazon slashed costs by switching to the Linux open-source operating system to power its servers.

Economists admit there's much they don't understand about productivity. Yet getting the outlook right will be crucial if the Fed is to successfully steer the economy forward. ■

—By Rich Miller in Washington, with Steve Hamm in New York



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MERCK: HOW MUCH MISERY AFTER VIOXX?

Bankruptcy seems unlikely, but lawsuits could be a drain for years

RARELY HAS A PAIN-killer caused so much pain. Since Merck & Co. withdrew its blockbuster drug Vioxx in September, the bad news hasn't let up. A big blow came on Nov. 8, when Merck disclosed it had been subpoenaed as part of a Justice Dept. investigation into research, marketing, and sales activities related to Vioxx. The Securities & Exchange Commission has also begun an informal inquiry into the matter. The following day, bond ratings agency Moody's Investor Service downgraded Merck's long-term debt. Those moves come even as Merck faces hundreds of lawsuits, and the prospect of hundreds more, related to the painkiller, which was pulled from the market after a study con-

firmed earlier fears that it was linked to an increased risk of heart attack.

So how bad might this get for once-mighty Merck? While it's impossible to say precisely what the Vioxx debacle will cost the drugmaker, analysts' estimates range from a few billion dollars to nearly \$20 billion. For now, Wall Street and some plaintiffs' lawyers agree that the Vioxx fallout is unlikely to lead to a Merck bankruptcy. That view, of course, could

change if the Justice probe uncovers evidence of criminal wrongdoing; then, all bets are off. "I think they can survive it," says Edwin C. Ciskowski, an analyst at Lincoln Equity Management Co. "But they will limp along, and Merck will be a very unattractive stock for many years."

Merck General Counsel Kenneth C. Frazier says the company has acted responsibly and that "it is not conceivable

CEO GILMARTIN Taking a hard-line approach to prevent a class action

that Vioxx suits could threaten its viability. Frazier says Merck will oppose any

move to consolidate the cases into a class action—something legal experts say the courts may support due to the differences among many plaintiffs. Instead CEO Raymond V. Gilmartin and his team aim to defend Merck vigorously against the cases individually, focusing on each plaintiff's medical history, the injury they may have suffered, and whether there is proof Vioxx was the actual cause. That strategy may be watched closely at rival Pfizer, whose painkiller Bextra has come under scrutiny for possible cardiovascular problems of its own.

HUGE BILL

BUT MAKE NO MISTAKE, despite Merck's hard-line approach, the legal bill is likely to be considerable. Merrill Lynch & Co. analyst David R. Risinger did an analysis of the potential liability based on the fact that 20 million Americans had taken Vioxx since its approval. He drew on a study by Kaiser Permanente earlier this year that showed that roughly 0.25% of those who took the drug had serious cardiovascular problems. That means some 50,000 people may have suffered consequences. Assuming that the size of average awards or settlements will range from \$100,000 to \$300,000, he then factored in other variables such as the likely success rate in court and added in other legal costs—including settling suits where Vioxx users didn't suffer a major cardiovascular event. The total hit: as low as \$4 billion, as high as \$18 billion.

But even that \$18 billion figure may prove conservative. Risinger warns that if criminal wrongdoing surfaces, in a worst-case scenario the cost could go even higher. "That increases the likelihood and magnitude of punitive damages," says Arnold Levin, senior partner with Levin, Fishbein, Sedran & Berman, who represented plaintiffs in the class action surrounding the diet drugs Pondimin and Redux. If the Justice Dept. probe results in criminal indictments, analysts warn, the company's survival could be threatened.

Merck, however, does have several factors that should give it decent odds of pulling through. For one thing, the drugmaker generates free cash flow of more than \$1.5 billion a year, even after spending more than \$3.5 billion on research & development, and another \$3 billion on its dividend. It could

THE STAT

\$18
BILLION

The high-end estimate of Merck's legal liability from Vioxx-related suits

Data: N.Y. Times & Co.



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strengthen its cash position by cutting that payout. Merck insists it won't touch the dividend; its battered stock, which has fallen more than 40%, to \$26, since Vioxx was recalled, would suffer even more. For now, analysts figure such a move would be premature, since the ultimate Vioxx liability is unclear. While Merck's borrowing costs will rise in the wake of Moody's downgrade of its long-term debt from Aaa to Aa2, SG Cowen analyst Stephen M. Scala

says that is unlikely to be a huge drag on cash flow.

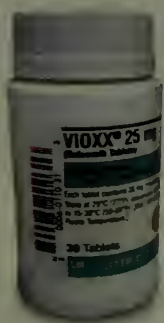
It helps that Merck's balance sheet is solid, with \$7 billion in cash and short-term investments. In addition, Merck and AstraZeneca have outlined plans to dissolve a partnership formed in the 1980s. Scala says that if Merck dissolves the partnership, it could pocket payments of \$9 billion or more by 2010, though that will

hurt earnings as Merck loses its cut of sales of AstraZeneca products. Scala also figures that Merck could get the money faster, if needed, by agreeing to cut its price.

Another factor in Merck's favor: The legal wrangling over Vioxx is likely to go on for years. That means Merck will have a long time to pay the bill. Consider Wyeth: Since withdrawing Pondimin and Redux in 1997, the company has reserved \$16.6 billion against its earnings for costs related to lawsuits and has not come close to insolvency.

Given how beaten down Merck's stock is, some investors might begin hoping that another drugmaker will swoop in and buy the company. That's unlikely. Investment bankers agree Merck's liability is simply too uncertain. "I don't think anybody would want to take this on," says one. The more likely prospect is a company that faces distraction and a financial drain for a long time to come. ■

—By Amy Barrett in Philadelphia



Merck insists that it won't reduce its dividend

BIOTECHNOLOGY

DIVVYING UP THE STEM CELL BONANZA

California's Proposition 71 has critics of conflicts and favoritism ready to pounce

LONG BEFORE CALIFORNIA voters passed Proposition 71 on Nov. 2, authorizing the state to pour \$3 billion of taxpayers' money into stem cell research, the measure generated plenty of debate. And it wasn't just conservatives opposing the measure on religious grounds. Even supporters of the research, which one day could lead to cures for everything from diabetes to cancer, argued that the law gives vested interests too much say over who will get the funds.

So as officials move to appoint an oversight committee that will weigh funding requests, they are mindful that critics will be watching their every move.

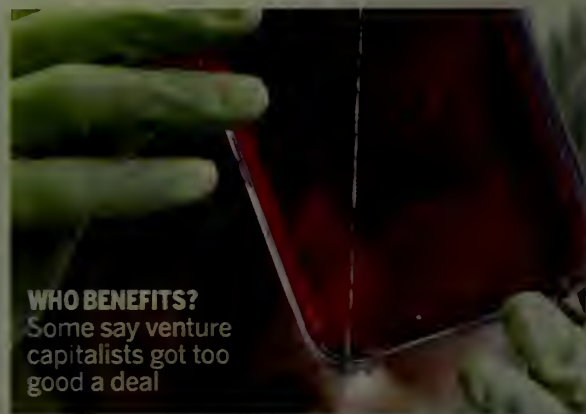
While architects of the law insist the appropriate checks and balances are built in, controversy continues to swirl around a decision-making process that some see as overly secretive. "Clearly the initiative is written to invite every conceivable form of corruption in the allocation of these funds," says Republican State Senator Tom McClintock, who opposed the law.

The controversy in California is broadly echoed at the federal level. Over the years the National Institutes of Health, which oversee federal research grants, have come under fire when pure research funded by the NIH ends up disproportionately benefiting private companies that license the technology.

In California, too, questions persist about who ultimately will profit from state-funded research. About half of the \$25

million raised to pass Proposition 71 came from venture capitalists. For the price of a campaign contribution, say opponents, VCs helped persuade taxpayers to fund \$3 billion of basic research. In 10 to 15 years, many of the same VCs will likely fund startups that license the fruits of that research—and benefit richly if those startups succeed. While many critics concede the important role VCs play in getting research breakthroughs to market, in this case they say the firms have gotten too good a deal. "If it doesn't work, VCs don't lose anything," says Mitchell Kapor, a software entrepreneur in San Francisco. "But if it does work, they get all these fundable companies."

Critics also argue that the state legis-



WHO BENEFITS?
Some say venture capitalists got too good a deal

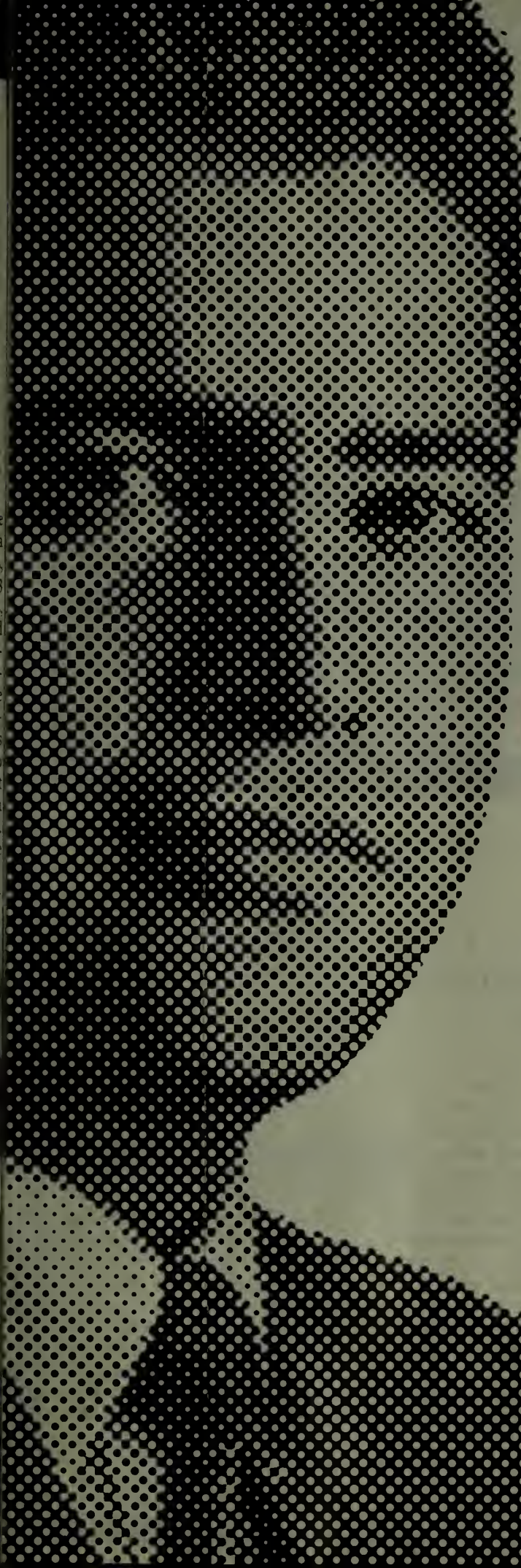
Balancing Act

The committee overseeing stem-cell research funding faces key challenges:

MANAGING the influence of patient groups that will lobby for research to fight specific diseases

KEEPING the funding process transparent while protecting intellectual property and privacy

ENSURING that both the state and private patent holders benefit from royalties and licensing revenue



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lature has too little say over how the newly established oversight committee will allocate grants. They note that Congress has budget authority over the NIH, including how much money goes to the various institutes. But the state assembly has no authority over the committee. "Here's a case where the authors did not want the legislature to meddle," says Fred Silva, a governmental relations expert at the Public Policy Institute of California think tank.

Then there's the composition of the committee itself. The law says the 29-member body be filled with experts from

California universities, research institutions, and life-science companies—the same organizations that will vie for grants, though most of the money likely will go to academia. What's more, the committee will have wide latitude in determining how private companies will pay to license technology derived from the publicly funded research. They face a difficult balance: While nonexclusive licenses are the best way to spread valuable technologies widely, companies often need exclusive licenses to make a profit.

Proposition 71's architects say they designed the law to avoid political interfer-

ence but think the process is fair and transparent. "We have two different fire walls that protect against conflicts," says Robert Klein, the real estate developer who helped write the law. First, committee members must recuse themselves from decisions affecting their group. Second, the working groups that make grant recommendations also must recuse themselves. In the end, success will be measured by whether \$3 billion in public money has benefited society—or only a handful of private companies. ■

—By Justin Hibbard in
San Mateo, Calif.

ART

MODERN ISN'T EVEN THE WORD FOR IT

New York's refurbished MOMA boasts futuristic technology to guide and inform visitors

THINK OF IT AS THE modernization of the Modern. Four years ago, New York's Museum of Modern Art embarked on an \$858 million rebuilding project. The new facility, which opens to the public on Nov. 20, has been widely lauded for its soaring atrium, wide-open galleries, and huge windows opening onto mid-Manhattan.

But MOMA's transformation goes well beyond steel and glass: Management grabbed the chance to install state-of-the-art technology, too. The upgrades—developed with help from IBM—include a wireless network, multimedia personal digital assistants that guide visitors through the

exhibits, and a 35-foot flat-panel display in the lobby where pulsating photos of art will be interspersed with instant updates on shows or lectures. The museum also is considering using wireless-tracking technology to monitor its 150,000 works of art, from three-ton sculptures to the tiniest drawings. When you "start with a clean slate," says MOMA Chief Operations Officer James Gara, "you're not anchored to the past. And that includes how you deal with technology."

MOMA's moves put it in the vanguard among tech-savvy museums at a time when many are under intense pressure to improve operating efficiency and draw more visitors. If these experiments pan out, wireless multimedia guides and oth-

er elements of MOMA's strategy could pop up at museums worldwide.

MOMA has big plans for its PDAs, which are basic Toshiba Corp. Pocket PCs. The first offering will be an architectural tour of the museum, featuring historic film clips and video interviews with architects and curators. "We want to enhance the art, not supplant it," says Steve Peltzman, MOMA's chief information officer. As the system gets up and running, the state hopes to tap into the wireless network so visitors can access information on the fly from the museum's digital archives. Ultimately, art watchers should be able to log onto MOMA's Web site and customize their tours, which will be downloaded to handheld when they arrive.

There's plenty of new technology coming behind the scenes as well. Next year MOMA will experiment with the radio frequency-identification technology used by the likes of Wal-Mart Stores Inc. to track inventory. The museum hopes RFID can be adapted to track works of art.

Don't expect MOMA's tech relaunch to be glitch-free. During a recent test, CIO Peltzman had to make minor adjustments to the ticketing system. But once the kinks are worked out, this stuff could be nearly as artful as the art itself. ■

—By Steve Hamm in New York



PELTZMAN
"We want to enhance the art, not supplant it," the CIO says

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IRAR070299

EDITED BY ANNE NEWMAN

HEADLINER

MICHAEL
CHERKASKY



MARSH MEDICINE

Michael Cherkasky, 54, is taking some tough steps to resurrect **Marsh & McLennan Cos.** from the massive scandal over bid-rigging and kickbacks. On Nov. 9, the new President and CEO announced that the world's largest insurance broker would cut 3,000 jobs, or 5% of the workforce, to cope with the aftermath of the investigation by New York Attorney General Eliot Spitzer. Cherkasky was a Spitzer colleague at the Manhattan District Attorney's office who went on to head Marsh Kroll, MMC's risk-consulting unit, before being tapped as CEO.

Cherkasky also announced that Marsh Mac's third-quarter net earnings plunged 94%, to \$21 million. He blamed the drop on the need to set aside cash for a settlement and on plunging revenues from the controversial fees that brokers got for channeling business to certain insurers. With those fees now a thing of the past, the next challenge is finding a new business model to maintain the company's once-healthy margins.

-Diane Brady

FALLOUT FROM A CISCO SKID

Cisco Systems sent a chill through the market on Nov. 9 with a tepid forecast of 1%-to-3% revenue growth for the current quarter, vs. the 3%-to-4% most analysts expected. Its stock fell 6%, to 18.55, on Nov. 10. Since Cisco is a bellwether of tech spending, the news sent NASDAQ down as well. But Cisco's problems may be partly self-inflicted. Sales of its core networking routers have fallen for two straight quarters while rivals such as **Juniper Networks** increase their share. "Cisco is getting more aggressive on price," says rival Steve Kaufman of **Avici Systems**. "But I don't see it getting better for them anytime soon."

A DEEPENING DISNEY DRAMA



It was a busy week for Roy Disney on the governance front. The former **Walt Disney** director and critic of CEO Michael Eisner won approval from a Delaware court to appeal a lower court ruling that blocked him from releasing board deliberations in determining Eisner's pay package—a key part of his strategy to force out the longtime Disney chief. Meanwhile, Disney and fellow dissident and financial adviser Stanley Gold are

marketing a new \$1.25 billion corporate governance fund aimed at investing in troubled companies. The fund would then push for improved board oversight and better management. The **Shamrock Activist Value Fund** said in an SEC filing that it had received \$220 million from investors so far.

WEB PHONES: OFF THE HOOK

The Federal Communications Commission took a major step to encourage phone calling over the Internet. On Nov. 9 it said Net phone service provided by the likes of **Vonage Holdings** and cable companies will be subject to lighter federal, not state, regulation. Without a patchwork of rules from 50 states, Web-phone providers may have fewer costs. If traditional telcos such as the Bells design their voice-over-Internet services like Vonage, then they will get light regulation, too. But the FCC hasn't decided if, or how, Net providers will offer 911 service, pay subsidies guaranteeing all users affordable phone service, and cover their tab to other carriers to help place their calls.

TECH'S MONEY MANEUVERS

For tech companies, the pressure to keep investors happy is on. On Nov. 10, **Intel** said it will double its quarterly dividend to 8¢ a share beginning Mar. 1. The chip giant also authorized the buyback of 500 million shares of stock, worth \$11.4 billion at today's prices. The move comes a day after **Microsoft** investors approved a plan for the software giant to pay out a special \$32

billion one-time dividend. Tech companies have come under increasing criticism when they pile up large cash hoards, rather than returning funds to investors. Execs, frustrated with water-treading stock prices, are beginning to see higher dividends as a way to attract new investors.

ET CETERA...

► **MGM Mirage** is building a \$4 billion city/resort on the Las Vegas strip.

► **IBM's Blue Gene/L** came in first in a closely watched biannual ranking of the world's fastest computers.

► **Starbucks'** 2005 sales forecast fell below analysts expectations for the year.

CLOSING BELL

Anthem moved closer to being the largest U.S. health insurer on Nov. 9, after California regulators O.K.'d its \$16.4 billion deal for **WellPoint Health Networks**. The two will spend \$265 million to improve health care in the state. Anthem shares rose 5.5% to close at \$91.23.



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*Some components and features are made using many U.S. sourced parts. **Direct U.S. employment: 31,040 jobs as of 12/03. ©2004

EDITED BY MIKE McNAMEE

The SEC: What's on Donaldson's To-Do List

BY MOST ACCOUNTS, SECURITIES & EXCHANGE Commission Chairman William H. Donaldson is a short-timer. But don't tell his scheduler. The week after the election, the SEC chief jetted to Florida to lecture stock traders at their annual confab, spoke to leaders of charities in Chicago, and was back in Washington in time to

propose stricter governance rules for U.S. stock exchanges. Donaldson, 73, is acting as if he plans to stick around through 2005—to the dismay of some business leaders who had hoped for a breather from post-Enron activism.

SEC insiders say Donaldson is eager to complete an ambitious agenda and roll out new initiatives. Top priorities include modernizing stock trades, finishing mutual-fund reforms aimed at preventing trading abuses, and forging a compromise to make it easier for shareholders to nominate company directors. Next on Donaldson's to-do list: requiring companies to disclose more about executive perks and pay. And he wants to clarify the opaque process for giving SEC recognition to credit-rating agencies, paving the way for new competitors.

The leftover issues are technically thorny and involve compromises that will leave no one satisfied. Under pressure from the SEC, the New York Stock Exchange is expanding electronic trading, a move that will squeeze its specialists and floor brokers. But the SEC won't give the NYSE's electronic-trading rivals the big opening they want to snag more business, either. "Whatever the SEC decides, there will be howls all around," says Council on Foreign Relations finance expert Benn Steil.

The SEC's stream of governance rules and zero-tolerance enforcement have left Corporate America resentful, too. "The SEC is operating beyond its authority," says David Hirschmann, senior vice-president of the U.S. Chamber of Commerce. The Chamber sued the agency in September over a new

rule requiring mutual-fund chairmen to be independent of fund-management companies. And lobbyists gripe about the proliferation of probes into possible corporate wrongdoing. The SEC filed 639 enforcement actions in the year ended Sept. 30, just shy of '03's record 679 cases. But total penalties edged higher—\$1.2 billion vs. \$1.1 billion. And SEC-ordered disgorgements of ill-gotten gains doubled, to \$1.8 billion.

Lost Ally

DONALDSON ISN'T LIKELY to ease up. His vigilance has won kudos from the White House and Capitol Hill. And with New York Attorney General Eliot Spitzer on the prowl, the SEC can't risk being tagged as soft on enforcement. "We ought to be tough because accountability and deterrence are what make the system work," says SEC Commissioner Harvey J. Goldschmid.

But the time for toughness may be brief. Democrat Goldschmid plans to return to Columbia University School of Law next fall—depriving Donaldson of a key ally and intellectual force in SEC debates. "When he leaves, the delicate balance Donaldson has built risks unraveling," says Joel Seligman, dean of Washington University School of Law.

Donaldson backs some initiatives that please business. His plan to streamline stock-sale registration and let companies speak more freely ahead of public offerings will make it easier to raise capital, says Michael J. Missal, a partner at law firm Kirkpatrick & Lockhart. But corporate leaders who want more such respites from the SEC may have to wait out Donaldson. ■

—By Amy Borrus



A LONG GOOD-BYE? Donaldson may not be leaving as soon as expected

CAPITAL WRAPUP

ROYALTY, AMERICAN-STYLE

THE ELECTION was a big win for the **Bush** dynasty. But it also was a night of victory for four other Washington political families:

Republican Connie Mack IV, a marketing executive and son of former **Senator Connie Mack III**, sailed into a House seat on Florida's Gulf Coast after a tough primary. With a boost from the Chicago Democratic machine, **Representative-elect Dan Lipinski (D-Ill.)**, a political science professor, replaced his father, **Bill**, who retired after 11 terms. Also winners were Democratic **Representatives-elect Dan Boren** of Oklahoma,

son of former **Senator David Boren**, and **Russ Carnahan** of Missouri, son of former **Senator Jean Carnahan** and the late **Governor Mel**. Two years after his mom's defeat by **Republican Jim Talent**, Russ capitalized on the Carnahan name to capture the seat vacated by former **House Minority Leader Dick Gephardt**.

A new dynasty was born in Colorado, where the **Salazar brothers**, **Senator-elect Ken** and **Representative-elect John**, both seized seats previously held by Republicans. They join Michigan's **Levin brothers** as the second House-Senate sibling tag team.

Of course, legacy lawmakers are nothing new. Michigan **Representative John Dingell** replaced his father—in 1955. Rumor has it that when Dingell retires, son **John Jr.** is in line to take his place.

—By Richard S. Dunham

There are now two House-Senate pairs of brothers

24/7 CUSTOMER
Talking to
suitors?



INDIA

LET THE DEALS BEGIN

As Bangalore's outsourcing industry surges, takeovers will be fast and furious

IT FELT LIKE THE LIGHTS WENT on again in Bangalore. Almost as soon as U.S. President George W. Bush was reelected and the specter of a Democratic Administration that might pull the plug on outsourcing receded, the deals began to flow. On Nov. 8, Infosys Technologies Ltd., India's top software services company, announced a \$1 billion secondary offering of its shares. That same day, General Electric Co. sold a stake in its New Delhi-based outsourcing subsidiary to U.S. investors for \$500 million.

Bangalore is talking deals again. India's \$16 billion tech outsourcing sector—

centered around the southern city of 6.5 million—is growing at 30%-plus annually as ever more foreign companies farm out help desks, software writing, accounting, and more to armies of young Indians manning phones and computer workstations day and night. By 2008 the business could bring in \$50 billion a year, estimates India's software services trade association, Nasscom. The group believes as much as 30% of corporate tech work can be outsourced, and so far less than 10% has been.

That potential has dealmakers from around the world licking their chops. In the next 18 months, investment bankers

are expecting a wave of mergers and acquisitions as competitors rush to achieve the critical mass needed to serve global clients in everything from call centers to financial analysis. "It's going to be a sizzling sector," says Vedika Bhandarkar, head of investment banking at J.P. Morgan India. "There will be more M&A, more consolidation, more U.S. listings."

FIERCE COMPETITION

BOTH MULTINATIONALS and locals will be jockeying for position. Even though business is booming, so many companies have sprung up that pricing competition has become cutthroat. In all, India has

IF IM PER FIR CO

...less
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...data
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Wipro-
...amind, the
...office arm of
...pro Ltd. And
...their demand for
college grads is so
great that half the
workers at many
outsourcing com-
panies quit every
year to take better
jobs. That's driving

...osts: Wipro and Infosys this year
boosted wages by 10% to 15% across the
board to keep workers from jumping
ship. "Large acquisitive players will see
[M&A] as a means of reducing competi-
tion," says Pradeep Mukherjee, manag-
ing director of neoIT.com Inc., a Banga-
lore outsourcing advisory firm.

There's likely to be a scramble
to gain local knowledge,
too. The outsourcing industry
was pioneered by the Indians,
and the most successful shops
have been homegrown. Except
for GE and Citibank, foreign
operators came late to the
game and have been playing
catch-up. In April, IBM Global
Services paid \$150 million for
New Delhi's Daksh, a call-center
operator with 6,000 work-
ers and customers around the
world. That purchase catapulted
IBM into the top ranks of In-
dian outsourcing players. In-
vestors say other U.S. services
firms may seek similar deals.
Like IBM, Accenture and EDS
will look to buy scale here,"
predicts K.P. Balaraj, managing
director of VC firm WestBridge
Capital. Accenture declined to

EDS says it is more likely to
growth.

...age of potential tar-
...ors are talking to
...00-person call-cen-
...alore funded by Cal-
...Capital. VCustomer, an
...about 4,000 employees in
...ne and backed by private eq-
...Warburg Pincus LLC, is also a
...target. Neither company would
...in any takeover talks.

FOR GRABS

IT'S NOT JUST LOCALS that are up for
grabs—as the GE deal shows. The U.S. gi-
ant set up its back-office operation in In-
dia in 1997. Since then the unit, GE Cap-
ital International Services (Gecis), has
grown into a \$430 million giant with
17,000 employees in four countries han-
dling sophisticated processes such as data
modeling and actuarial analysis, in addi-
tion to customer service. Now, though, GE
thinks Gecis will fare better as a semi-in-
dependent shop serving a diverse cus-
tomer base rather than just GE. So it's
selling off 60% of Gecis to U.S. venture
funds General Atlantic Partners LLC and
Oak Hill Partners LLC for \$500 million.
"We want to build a global business,"
says Gecis President Pramod Bhasin.

Bankers expect more such sales. Like
Gecis, the Indian call-center and back-of-
fice operations of the likes of American Ex-
press and Standard Chartered Bank may
have grown so big and expensive com-
pared with local players that it no longer
makes sense to keep them in-house. Both
have more than 4,000 employees in India.

But because such outfits serve only their
parent, they aren't as hungry and aggres-
sive as homegrown players. Analysts say
the costs of these so-called captive out-
sourcing operations are up to 40% higher
than local rivals'. "They will face the same
value-unlocking pressures that GE faced
before deciding to spin off its back-office
operation," says Prasad Baji, vice-presi-
dent at Bombay boutique investment
bank Edelweiss Capital Ltd.

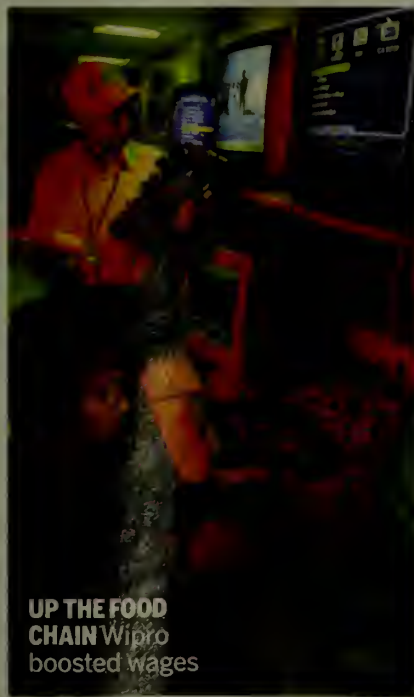
The purchases aren't just one way. So
far most jobs flowing to India have been
relatively low-level call-center positions.
But as India's outsourcers take on more
sophisticated work such as analyzing bal-
ance sheets or managing logistics, they
are looking to buy operations overseas.
On Oct. 30, Scandent Group, an Indian-
owned Singapore company with opera-
tions in Bangalore, bought Cambridge In-
tegrated Services Group, the \$230
million back-office arm of Chicago insur-
er Aon Corp., for an estimated \$175 mil-
lion. That makes Scandent the third-
largest insurance back-office outfit in the
U.S. While Cambridge will remain a U.S.
company, Scandent plans to list it on the
Indian stock exchange.

Other Indians are on the prowl. A year
and a half ago, Wipro-Spectramind got
2% of its revenues from processing insur-
ance claims and providing accounting
services. Today the sector represents 15%
of the company's business, so Spectra-
mind plans to "proactively target that
market" and is weighing acquisitions,
says CEO Raman Roy. Computer maker
HCL Technologies Ltd., which gets 65%
of its revenues from call-center-based

tech support for the
likes of British Tele-
com, wants to buy a
U.S. company that
will add skills such as
financial analysis.

There's no short-
age of ambition in
Bangalore. Although
worries in the U.S.
about jobs flowing
overseas could still
slow the sector's M&A
activity, the possibility
of a serious backlash
against outsourcing
seems to have faded
with Bush's reelec-
tion. So bring on the
dealmakers. ■

—By Manjeet Kri-
palani in Bombay,
with Josey Puliyanthu-
ruthel in Bangalore



UP THE FOOD
CHAIN Wipro
boosted wages

Bangalore The Next Act

Why dealmakers are
salivating:

MORE MONEY: Sales and profits
at Wipro, Infosys, and TCS are
growing by 40%-50% annually.

MORE JOBS: Indian outsourcing
employment is up by 16% in the
past year, to 850,000. Some
1.3 million more jobs are
expected to be created by 2009.

MORE DEALS: GE is selling its
India-based outsourcing shop for
\$500 million. U.S. insurer Aon
sold its outsourcing unit for an
estimated \$175 million.

Data: Company reports, *Nation's BusinessWeek*

COMMENTARY

BY JASON BUSH

Oil: What's Russia Really Sitting

As more oil becomes recoverable, reserve estimates are skyrocketing

WITH OIL STILL hovering near \$50 a barrel, the last thing people want to hear is that there's even less of the stuff out there than previously thought. This year investors in the oil industry have been shaken by the revelation that Royal Dutch/Shell Group overstated its proven reserves by at least 23%, some 4.5 billion barrels, with more possible downgrades to come. There's growing disquiet that other major oil companies may also have inflated reserves.

But there's one place—Russia—where reserve estimates just seem to go up and up. In its annual statistical survey of world energy, BP PLC has recently revised its estimates of Russia's total proven oil reserves to 69.1 billion barrels, 6% of the world's total, up from 45 billion bbl. in 2001. But according to auditors with a worm's-eye view of what's actually going on in the depths of Siberia, such estimates may just scratch the surface of Russia's real potential. According to a recent study by Dallas-based energy reserve auditors DeGolyer & MacNaughton, whose clients include leading Russian energy companies such as Gazprom and Yukos, Russia's true recoverable reserves are between 150 billion bbl. and 200 billion bbl. That's up from industry estimates of 100 billion bbl. a few years ago.

Why such a big gap in the estimates? Because it's one thing to be sitting on oil reserves, another to be able to exploit them commercially. In Russia's main oil-producing region in western Siberia, proven reserves represent just 18% to 24% of all oil in the ground, in contrast to about 45% in Western oil-producing regions such as Alaska and the North Sea. But as Russian oil companies adopt technologies, such as horizontal wells and computerized reservoir management systems, the estimated recovery rates are being revised. Thanks to new techniques, which make it possible to obtain oil even from apparently depleted fields, Russian oil companies already have managed to boost their output by 50% since 1998. "The biggest thing is the [new] technology being deployed in western Siberia. The results are beginning to show," says Martin Wiewiorowski, senior vice-president of DeGolyer & MacNaughton in Moscow.

This increasing recoverability, and not dramatic new discoveries of oil, explains why Russia's proven reserves keep shooting up. The leading Russian oil companies have all announced big increases this year, following independent international audits. Lukoil, Russia's largest oil outfit, saw a boost of



LUKOIL PUMP PLANT
Rising reserves will draw more investment

Better technology, not new discoveries, is providing the boost

4.7% in proven reserves both year and last, according to Society of Petroleum Engineers (SPE) standards. No. 2 producer Yukos meanwhile, jumped 13.2% this year, according to stringent standards set by the U.S. Securities Exchange Commission.

The growth in Russia's proven reserves is mainly happening at existing fields in western Siberia, supposedly "mature" region where production had been declining

recently. DeGolyer & MacNaughton predicts that western Siberia could boost its output to 10 million bbl. a day by 2012, from less than 6 million at present, and keep production at that level for at least 10 years. The use of even newer technologies available by then means that western Siberian oil production may not decline for decades to come. Russia's reserve potential is vaster still when undeveloped regions, such as the Arctic and Caspian, and in particular eastern Siberia, are factored in. And then there's Russia's plentiful supply of natural gas. It is already acknowledged as having the world's largest gas reserves, with 44 trillion cubic meters, or 26.7% of global reserves.

But tapping Russia's vast oil pool will require billions in investment, especially in export pipelines. Although on course for 8% growth this year, production gains could slow as export bottlenecks appear. But infrastructure investment is likely to go up in tandem with reserve estimates. If Russia finds a way to get all that lovely oil to needy international consumers, its day as a global energy powerhouse could be just beginning. ■

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HEALTH

EUROPE: WHERE THE SMOKE IS CLEARING

Many countries are finally getting serious about banning smoking in public places

IT'S POURING RAIN ON FRIDAY evening in Cork city center, and pub owner Gareth Kendellen is thrilled to have a hole in his roof. In fact, it has saved his business. When Ireland became the first country in the world to ban smoking in all workplaces, including bars and restaurants, on Mar. 29, Kendellen watched customers dwindle and sales plunge 30% at his Paddy the Farmer's pub. Then he hit on a radical solution, spending \$25,500 to cut a hole in the roof and create a 50-square-foot room beneath it, open to the sky but separated from the rest of the pub by brick and glass walls. His Players-puffing patrons flocked back, secure in the knowledge that an outdoor smoke hole was just a step away. "Takings are back to normal, although we have to keep a stock of free umbrellas behind the bar," he says.

Looks like a lot more European bar owners are going to have to pull out the saws pretty soon. Under pressure from medical organizations and restive non-smokers, national governments around Europe are finally getting serious about

tackling tobacco. Norway and Malta have already followed Ireland's lead, and Sweden will join the club next summer. This month, Britain is expected to announce its own curbs, which industry observers predict will outlaw smoking in restaurants and pubs that serve food. Even in France, where restaurants and Gauloise seem as indelible a partnership as croissants and coffee, enforcement of a largely ignored restriction on indoor smoking has been stepped up.

The anti-smoking campaigns are starting to work. Cigarette sales in Europe, excluding heavy smokers Greece and Portugal, have fallen 6.3% in the past two years, says British research group Euromonitor International, and they are expected to drop an additional 6.4% by 2009. "There has been a recent shift in public opinion against smoking," says Zora Milenkovic, Euro-

WAITING TO INHALE

Pub patrons in Dublin

monitor's head of tobacco industry research. "More people than ever

are aware that passive smoking can kill and I think more countries will start cracking down."

Ireland's example gives European bar owners and tobacco companies plenty to worry about. Gallaher Group LLC, which holds half the Irish cigarette market and is Europe's third-largest tobacco company, says the ban helped push total cigarette sales in Ireland down 7.5% in the first six months of 2004. Gallaher is campaigning through the Tobacco Manufacturers Assn. for softer regulations in Britain, where it has 38% of the market. "We understand that restrictions need to be made, but I hope Britain stops short of pubs," says Tim Lord, chief executive of the Tobacco Manufacturers Assn.

GRUESOME PICS

OUTRIGHT BANS aren't the only weapons wielded by politicians. The European Union in October called on governments to put gruesome pictures of cancerous growths and blackened lungs on cigarette packs. Many countries are using tax hikes to suppress sales. Germany added 32¢ a pack in levies in March, 2004, bringing the average price of a pack of smokes to \$4.90, and will hike taxes by the same amount in December and then in September, 2005.

But higher taxes don't always have the expected results. In France, tax hikes to cover a hole in the social security budget have raised the price of an average pack by 39% over the past two years, to \$6.40. That has led to a 30% plunge in cigarette

sales, but not an equivalent decline in smoking, as consumers turn to the Internet, cross-border, and black-market sources.

Perhaps harder-hit than the tobacco companies are Ireland's world-famous pubs. A survey by market research firm Behaviour & Attitudes found that Dublin pub revenues fell by 16% in the first three months of the ban. Rural bars have seen receipts falling by a quarter. "I've

seen countless pubs up for sale since March," says Seamus O'Donoghue, president of the Vintners' Federation of Ireland. An Ireland without pubs? Now that's an unintended consequence. ■

—By Rachel Tiplady in Paris

THE STAT

6.3%

Decline in cigarette sales in Europe from 2002 to 2004*

* Excluding Greece and Portugal
Data: Euromonitor International



The evolving responsibility of business to reflect society

by the parent company of Kraft Foods, Philip Morris International and Philip Morris USA

What makes a responsible company? Over years and even decades, the answers from society to this question have evolved considerably.

At Altria Group, the ways in which we are striving to meet societal expectations also continue to evolve. An important element is our commitment to listen to all sectors of society, including our companies' critics. Not just to detect shifts in society's expectations, but to respond honestly and positively when we hear them.

We know that the right structures and processes must be in place throughout our companies so that the letter and spirit of laws are followed. But even more than this, the right values and skills must be instilled in our people. Each of our companies is working so that these things are in place.

As a company that is the parent of both food and tobacco companies we know we have a role to play. Our commitment to employees, shareholders, our companies' consumers, regulators and society as a whole is to continually make progress as we move forward.

Our name is Altria Group.



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EDITED BY ROSE BRADY

China: A Bit of Theater Starring the Yuan

IT LOOKS LIKE A POST-REELECTION present for President George W. Bush. In the wake of the American vote on Nov. 2, Chinese officials have been signaling that Beijing is ready to adopt a more flexible currency regime—just as Washington and U.S. manufacturers have long demanded. Suddenly the currency markets are abuzz in anticipation of a yuan revaluation, a move that could slow the onslaught of Chinese exports to the U.S.

Not so fast. Although some China watchers believe Beijing is ready to move towards a more market-based financial system, it's unlikely the Americans will get the stronger yuan they want. Indeed, when People's Bank of China Vice-Governor Li Ruogu said on Nov. 4 that Beijing "had already made a host of fundamental preparations" for exchange-rate flexibility, he was reiterating what the government has said for some 10 years—that it has a policy of slowly liberalizing its exchange rate. He added that the PBOC intends to keep the yuan "basically stable."

The message is clear. China wants to introduce more flexibility into its currency system, and so stave off U.S. pressure. But any changes will be incremental, within Beijing's time frame, and designed to keep China as competitive as ever. Over the next half year, China is likely to widen slightly the narrow band within which its currency is pegged to the U.S. dollar. The impact would be a one-time yuan revaluation, perhaps by a couple of percentage points, as it rises to the top of the band. The government could also link the yuan to a trade-weighted basket of currencies rather than the U.S. dollar. But none of these steps would have a dramatic effect. "Making the currency more flexible does not equal freeing the currency," says Zhao Xijun, a professor in the School of Finance at People's University.

Why would the Chinese be content to tinker, given the calls for a major revaluation? One reason could be the consensus

leadership style of the government under President Hu Jintao and Premier Wen Jiabao. Adding much more flexibility to the yuan would require full agreement by China's top officials, and probably no one leader is willing to advocate the potentially destabilizing move toward floating rates.

Little Influence

ANOTHER REASON is that although Beijing wants to cool the economy, it does not want to make companies operating in China less competitive. Even if the yuan edges up, labor costs will remain some 4% of those in the U.S. And because Chinese manufacturers import most commodities

and components, a stronger yuan would lower the cost of materials. "Even if a revaluation were to have a negative influence on our exports, we also must buy many components from overseas," says Yin Weidong, a director at Zhejiang mobile phone maker Ningbo Bird Corp., which exports to France, Russia, and India. "So ultimately it would have little

influence on our competitiveness."

The Chinese have other ways to take the upward pressure off their currency, which has attracted speculators.

Beijing is allowing companies and individuals more freedom to exchange their yuan for foreign currency, which can offset the effects of speculative inflows of funds. "China needs to keep widening the band of people who can change money," says Hai Wen, deputy director of Beijing University's China Center for Economic Research. But for the Bush Administration, Beijing's noises on currency changes are likely to be more public relations than gift. ■

—By Dexter Roberts in Beijing



WEN Consensus leadership bars any big moves

GLOBAL WRAPUP

A BOOST FOR FRANCE'S SANOFI-AVENTIS

THE FRENCH government's goal of creating a national pharmaceutical champion got a big boost on Nov. 9 when Paris-based **Sanofi-Aventis** released promising data on an experimental drug that helps people lose weight and stop smoking. Hailed as a breakthrough in the treatment of obesity, **Acomplia** blocks the same biological trigger in the brain that gives cannabis smokers the munchies. Data from a two-year trial showed that patients taking **Acomplia** lost nearly four times as much weight as participants given sugar pills. Analysts expect **Acomplia**, which will likely be filed for approval in the U.S. and Europe by mid-2005, to be the new company's first blockbuster. **Sanofi** and **Aventis** merged earlier this year under French government pressure.

MORE BAD NEWS FOR MITSUBISHI MOTORS

JAPAN'S ONLY money-losing carmaker, **Mitsubishi Motors**, skidded further into the red on Nov. 8 when it posted a record \$1.3 billion net loss for the first six months from April. The company also slashed its forecast for the full year through March to a net loss of \$2.2 billion on sales of \$19.1 billion. The results have dashed hopes that the company, which has been dogged by a series of recall scandals in Japan, could rebound under a rehabilitation plan announced in May. Company President Hideyasu Tagaya is trying to keep production lines busy by supplying low-margin vehicles to other carmakers. Mitsubishi's stock price has dropped more than 50% since June and is trading just above the perilous 100-yen "penny stock" level.

First the Music, Then the Coffee

Starbucks' new chain of Media Bars is grabbing customers by the ears

When an album of Ray Charles duets, *Genius Loves Company*, hit stores in the late summer, music fans eagerly scooped up the CDs. Then the album went platinum. It was sweet validation for the issuing label, Concord Records—but also for its distribution partner, Starbucks Corp. Starbucks shoppers were responsible for one-third of the CD sales—more than any other retailer.

Starbucks has never been primarily about the coffee. Its pell-mell growth, which last year earned it the No. 25 ranking on the BusinessWeek 50 list of top-performing big companies, has always been about selling an experience. Now the Seattle company is making a major push to add new ways of listening—and buying—music for its 35 million weekly customers. Collaborating with record labels is just one element of that strategy. In October, Hear Music, an alternative record retailer that Starbucks bought five years ago for \$8 million, launched a satellite radio station that plays the kind of adult-oriented jazz, blues, and alternative rock that Starbucks has long featured in its stores. The company is also installing kiosks, called Media Bars, in its shops that let customers listen to digital music, create their own compilations, and purchase them while waiting for their grande double latte.

The next step: Starbucks is investing in new retail outlets that will be music stores first and coffee-houses second. The first two Hear Music Coffee Houses are already operating in Santa Monica and Berkeley, Calif. “This is not a gimmick, and

this is not an approach to take to sell more coffee,” says Kenneth T. Lombard, president of Starbucks Entertainment, the unit overseeing the music efforts. “This is a firm commitment to take advantage of our unique platform to discover and acquire music.”

Many Starbucks customers, of course, fall into the baby boomer demographic that tends to have both disposable income and a fear of the technology involved in finding and downloading music from the Internet. Those people also have drifted away from the traditional music business in recent years. But early on, Starbucks co-founder and Chair-

man Howard Schultz noticed that customers, while waiting for a mocha frappuccino, would ask about that catchy tune playing in the background. That got the chain selling CDs from the same artists at the cash register.

Now, with the in-store kiosks, it's possible to mix and match. You sit down on comfortable lounge chairs and use a stylus to click through different genres of music, picking out a single song or up to a dozen. You select from a choice of generic packaging. The bill—99¢ a song—is paid with a Starbucks card or credit card. Hit a button, and a CD burner spits out your disk in less than 10 minutes. The kiosks are in 45 stores in Seattle and Austin, Tex., and are rolling out nationally.

For those who don't have time to sip and browse, Starbucks launched its XM Satellite Radio subscriber service. Staffers program the music and will do live concert broadcasts with some of the musicians. In addition, the

channel will become the new house music for all Starbucks outlets.

So far, record labels are letting Starbucks sell some of the music from their catalogs—partly because they see it as a chance to crack the market for new adult music that they have largely ignored. Music sales make up less than 1% of Starbucks' total revenues, and it might be years before they turn a profit. That's

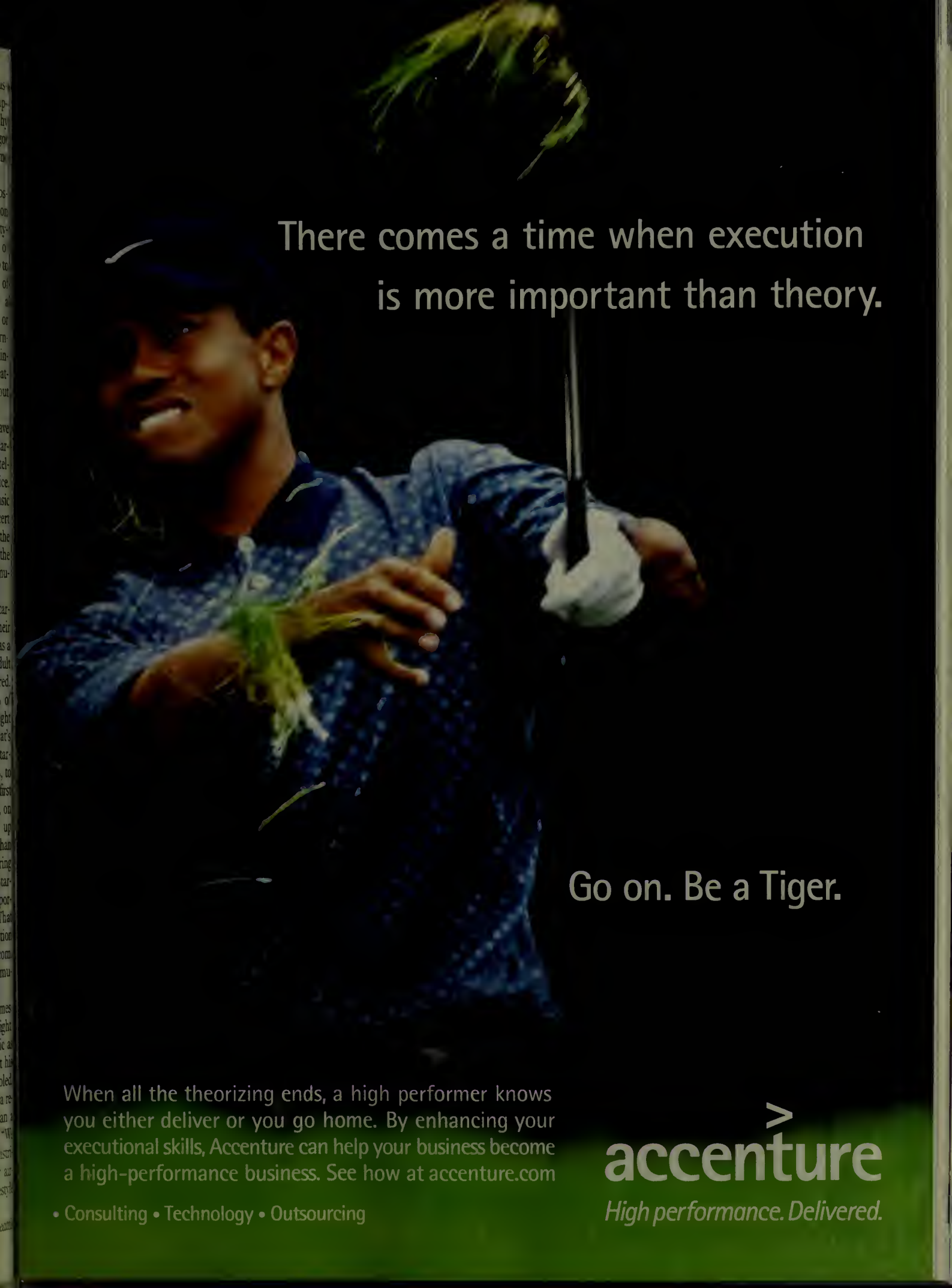
not a problem, since Starbucks' earnings rose 44%, to \$288 million, through the first nine months of this year, on revenues of \$3.8 billion, up 28%. Still, with more than 3,000 of its stores offering wireless Internet access, Starbucks may create its own portal for music downloads. That would put it into competition with WindowsMedia.com, iTunes, and other digital music powers.

When that day comes, Schultz could be in for a fight. But for now, he sees music as another way to signal that his baby won't be pigeonholed. “We are much more than a retail store. Much more than a coffee store,” Schultz says. “We are becoming alternative distribution.” By cup, disk, or airwaves, the Starbucks lifestyle marches onward. ■

—By Stanley Holmes in Seattle



BURNING CDs
Ray is one pick
amid thousands

A photograph of Tiger Woods in a blue patterned polo shirt and a dark cap, celebrating a golf victory. He is holding a golf club in his right hand and a bouquet of flowers in his left. The background is dark and out of focus.

There comes a time when execution
is more important than theory.

Go on. Be a Tiger.

When all the theorizing ends, a high performer knows you either deliver or you go home. By enhancing your executional skills, Accenture can help your business become a high-performance business. See how at accenture.com

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The American Institute of Architects honors the ten winners of the 8th annual BusinessWeek/Architectural Record Awards program

Design solutions that enhance business success

"Great designs demand great clients,"

observed Moshe Safdie, FAIA, jury chair of the eighth annual BW/AR Awards, invoking architect Louis Sullivan when describing the primary condition for the winning projects depicted here. Architects cannot do their best job without a client participating in and understanding the aims of a design. Clients can't use architecture to their best advantage without architects understanding the clients' business-driven mandates. Because collaboration plays so valuable a part in determining winning projects, jury members in this unique program are drawn from both the business/institutional communities and the design professions to assure

**These winners
illustrate the
entrepreneurial
spirit in
both management
technique and
building design**

a balanced vote. No other evaluation or honor awards program recognizes the value of design enhancing business performance.

In the submission narratives, architects describe how their designs respond to the needs of business clients, and clients provide concrete data on how design facilitated better business. Business here is broadly defined to encompass any entity that serves the public and seeks to succeed according to a variety of criteria, which may include employee retention, increased quality output, or enhanced publicity or branding. In the end, all the winners get to the heart of what collaboration is really about.



Fisher Pavilion at Seattle Center, Seattle, Wash.

Architect: The Miller|Hull Partnership

Client: City of Seattle, Seattle Center

The result of a public/private partnership, a new urban park and exhibition hall serves as a multipurpose public facility and communal gathering place.

"MoMA created a significant presence in an unlikely location."

— Betsy Cohen



MoMA QNS, Long Island City, N.Y.

Architect: Cooper, Robertson & Partners; Michael Maltzan
Architecture (associate architect for lobby and roofscape)

Client: The Museum of Modern Art

A temporary space to house the museum's collection while its permanent location closed for renovation.

"Designed in a minimal way, the project features state-of-the-art machinery enhancing the craft of blacksmithing."

— Paul Herzan



Iron Studio, Penland School of Crafts, Penland, N.C.

Architect: Frank Harmon Architect

Client: Penland School of Crafts

A new state-of-the-art facility that demonstrates the school's commitment to the iron-work trades.

"A result of very direct programming, a desirable location, and really nice buildings."

— Rand Elliott, FAIA



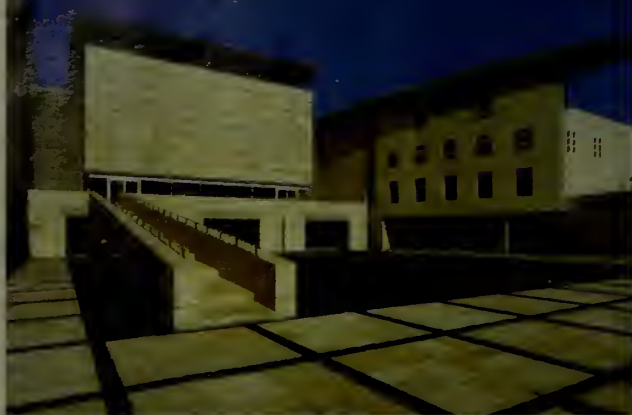
Humane Society/SPCA of San Antonio and Bexar County, San Antonio, Tex.

Architect: Alamo Architects

Client: Humane Society/SPCA of San Antonio and Bexar County

This animal shelter has used its design and location to increase adoption rates, lower animal return rates, and increase retention and recruitment of employees.

"Demanding security issues were integrated into the architecture so they became either environmental assets or invisible."
— Moshe Safdie, FAIA



Israeli Foreign Ministry, Jerusalem

Architect: Diamond and Schmitt Architects;
Kolker, Kolker Epstein Architects (associate architect)
Client: Israeli Foreign Ministry

This facility hosts administration offices, provides space for events and ceremonies, and serves as a model of security in the Middle East.

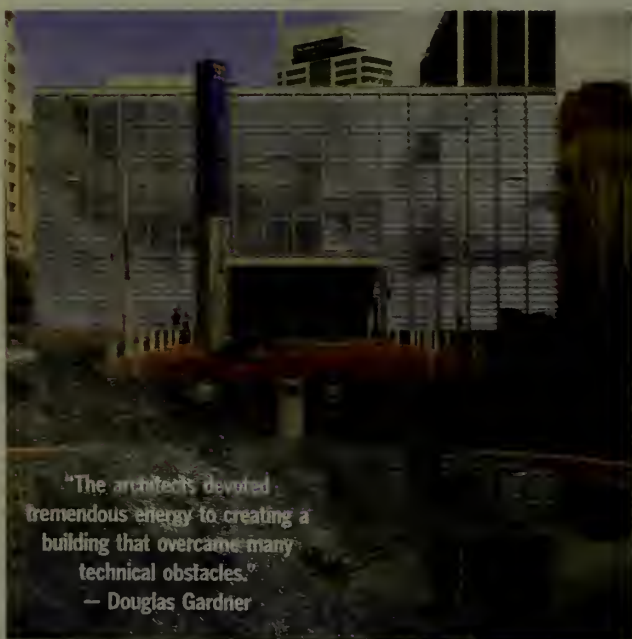
"It's like an Olympic Village. The traditional Japanese temple vocabulary elevates it to a romantic framework."
— Allison Williams, FAIA



Ehime Prefectural Budokan, Matsuyama City, Ehime, Japan

Architect: Ishimoto Architectural & Engineering Firm
Client: Ehime Prefecture

A state-of-the-art athletic facility improves the institution's overall national and international prominence and increases enrollment and visitors.



"The architects devoted tremendous energy to creating a building that overcame many technical obstacles."
— Douglas Gardner

Britomart Transport Centre, Auckland, New Zealand

Architect: JASMAX and Mario Madayag Architecture
Client: Auckland City Council Britomart Project Group

A renovation and redevelopment of the city's central post office to a major public transportation hub.

"A beautifully cast-in-place concrete structure using natural materials creates a very successful sense of place."
— Frances Huppert, FAIA



Finn Center, Community School of Music and Arts, Mountain View, Calif.

Architect: Mark Cavagnero Associates
Client: Community School of Music and Arts

The new, permanent home for this arts education organization serves the community and encourages all forms of art.

"Often these centers are just a roof. They don't have the emotional power of architecture, but this one really does."

— Rand Elliott, FAIA

James M. Wood Community Center, Los Angeles, Calif.

Architect: Lehrer Architects

Client: SRO Housing Corporation

This project serves as a safe harbor, aiding the recovery of addicts and providing for the homeless community at large.



"An attention to detail emanates from the building . . . indigenous materials used in a moving way."

— Frances Huppert, FAIA



Limerick County Hall, Limerick County, Ireland

Architect: Bucholz McEvoy Architects

Client: Limerick County Council

This civic building provides comfortable conditions for staff, reduces energy consumption, and facilitates easy access to information for the public.

Finalists

Quintessa Winery, St. Helena, Calif.

Architect: Walker Warner Architects

Client: Huneeus Vintners

FDNY Fire Zone, New York City

Architect: BKSK Architects

Client: FDNY Fire Safety Education Fund

University Health Network/The Toronto Hospital New Clinical Services Building Toronto, Canada

Architect: Hellmuth, Obata + Kassabaum

Client: University Health Network

General Mills, World Headquarters, Golden Valley, Minn.

Architect: Hammel, Green and Abrahamson

Client: General Mills

Marion Oliver McCaw Hall, Seattle, Wash.

Architect: LMN Architects;

Streeter & Associates (associate architect)

Client: The Seattle Center

Hotel Monaco (Tariff Building), Washington, D.C.

Architect: Michael Stanton Architecture;

Oehrlein & Associates Architecture

(associate architect)

Client: Kimpton Hotel & Restaurant Group;

General Services Administration-Portfolio

Management

Brentwood Skytrain Station, Burnaby, Canada

Architect: Busby + Associates Architects

Client: Rapid Transit Project 2000

Ford Rouge Center, Dearborn, Mich.

Architect: William McDonough + Partners

(concept design architect and master planner);

ARCADIS (architect, Dearborn Truck Plant)

Client: Ford Motor Company and

Ford Motor Land Development

San Francisco Ferry Building, San Francisco

Architect: SMWM;

Badauf Catton Von Eckartsberg (retail architect);

Page & Turnbull (preservation architect)

Client: Port of San Francisco;

Wilson Meany Sullivan; Equity Office Properties



We're Good Guys, Buy from Us

Companies are trying out innovative charity drives to burnish their brands

ON A RECENT AFTERNOON, a dozen people milled around a Target Corp. store in Manhattan's Times Square, poking through cashmere hats and white cotton T-shirts. But this wasn't your typical football field-size megashop: It was just 2,100 square feet. Every item for sale was pink and white, from scarves to leatherbound journals. And on Oct. 31 the shop closed for good. Far from a

failed attempt at a new retail format, it was a "pop-up" shop with a planned 30-day life—and a purpose. All the profits from the temporary Target store, located at one of the world's busiest intersections on 42nd Street and Broadway, were marked for breast cancer research.

Target is one of a handful of major marketers that are trying to rewrite the art of corporate giving. They're experimenting with several unusual ways to enlist customers as advocates for their good works rather than merely issuing the usual press

PRETTY IN PINK
Target's "pop-up" store in New York

release. Consumers, especially those under 30, are turned on by brands that can boast exemplary ethical

track records and community involvement. And time-strapped parents like the idea of pitching in for a good cause as the shop with their kids.

The pressure for brands to differentiate themselves from competitors is more intense than ever, and finding a cause that customers can embrace is one way to lead ahead. "There are people who will travel further and pay a bit more if they'll feel better about their purchasing decision," says Joe Marconi, consultant and author of a book on cause marketing. *The IE Sponsorship Report*, a Chicago trade publication, projects that companies will spend \$991 million on cause marketing in 2004, up 57% from 1999.

A well-constructed campaign can reap benefits for marketer and cause alike. Nike Inc., which has worked hard to restore its reputation after allegations of sweatshop conditions in its overseas factories, set a standard for engaging customers with a simple yellow plastic bracelet. In May, the company gave \$5 million to the Lance Armstrong Foundation for cancer research and cranked out bracelets in the same color as the biker's Tour de France jersey to sell on the foundation's Web site for \$1 a pop. The hoped the Wear Yellow Live Strong campaign would raise \$5 million. To date, it has pulled in four times that amount in online sales alone. "People are even giving them out at wedding receptions," says Nike spokesperson Trisha Burns.

NOT OPTIONAL

COMPANIES THAT SPEND a bundle on cause marketing are definitely interested in burnishing the brand, but for many, supporting a popular cause is no longer optional. It's what you have to do just to get to the starting line with the newest generation of consumers. Today's teens and twentysomethings grew up viewing community service as an ordinary pastime, not a college admissions requirement. More than 60% of the teens surveyed a year ago by youth marketing firm Allo-

Upholding The Cause

How companies are doing good—and helping themselves

TARGET

Donating profits from Web site and Times Square pop-up shop—open for just one month—to breast cancer research

NIKE

Raising more than \$20 million so far for cancer research through sales of its now-ubiquitous \$1 yellow bracelets

STARBUCKS

Sponsoring literacy programs, including in-store book drops, as well as a holiday gift drive for seriously ill children

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COMMENTARY

BY STANLEY HOLMES

Soccer: Time to Kick It Up a Notch

The MLS looks healthier. Now its game needs spice

Inc. said they are more likely to buy brands that support charitable causes. Their loyalties may also have a big effect on what their parents purchase. "Kids used to influence where you'd go to dinner, but now they influence what kind of car you buy," says Samantha Skey, a senior vice-president at Alloy.

Does cause marketing pay off? Target hasn't said how much came from the Times Square store, but it sold 20,000 pink bracelets in the first week. In 2003, it doled out \$27 million to schools through the Take Charge of Education program, which donated a percentage of charges on the store card. In total, Target gives some \$2 million a week to various causes. "Our guests feel good shopping

Young shoppers favor brands that back a cause

with us because they know they're contributing to many great causes as they shop," says John Remington, Target's vice-president of event marketing and communications.

Other cause marketing efforts are harder to measure. In October,

footwear maker Timberland Co. used an ad in *Vanity Fair* to drive people to its Web site, which includes a matchmaking service to unite would-be donors with causes. The ad included biodegradable postcards embedded with wildflower seeds that produce flowers when the whole card is planted. Was any actual cause, other than Timberland's own brand, helped? More than 8,000 people this year have been matched to community projects in 36 states. "We don't see it as an ad campaign but as a community campaign. It's what our brand DNA is all about," says Carol Yang, vice-president of global marketing.

She had better hope that customers see the campaign the same way. Cause marketers have to keep the overt branding to a whisper or they risk turning off the very people they're trying to woo. Teenagers and twentysomethings, especially, can smell advertising a mile away, says Carol Cone, CEO of marketing consultant Cone Inc. There is no swoosh on Nike's simple yellow band, for example, just the word LIVESTRONG. "It's what Lance believes in," says Nike's Burns of the slogan. Admirable. And for Nike, quite possibly profitable as well. ■

—By Lauren Gard in New York

AS MAJOR League Soccer kicks off its ninth MLS Cup finals on Nov. 14, there are indications that American-style pro *fútbol*—written off for dead again and again—may finally have legs. German sporting giant adidas-Salomon recently announced that it will inject about \$100 million into MLS over 10 years to become its key sponsor. Attendance is up 4.4% over last season. Soccer phenom Freddy Adu grabbed national media attention in his debut year. In 2005 the league is expanding to 12 teams from 10, and it plans to build four soccer-specific stadiums.

But it's still way too early to proclaim a turnaround in a pro league that has lost more than \$350 million since its kickoff in 1996. MLS Commissioner Don Garber argues that the league's strategy is solid: "We want to grow slowly and steadily and be in as many markets as we can when the sport really hits," he says. "Our goal is to create a soccer nation in this country."

The question is: Does Garber understand that strategy isn't enough—that the joy of soccer springs from 90 minutes on the pitch? That's why people fill stadiums around the world—to watch the "beautiful game." While there may be sound business reasons to focus on clever marketing schemes and building new stadiums, such a focus has come at the

expense of the quality of play. For the MLS to take advantage of its business successes, it has to put more energy and money into raising the level of its game.

Parity's Perils

BECAUSE THE DIRTY little secret is that most Americans still greet the MLS with a big yawn. Many serious U.S. soccer fans ignore MLS games for higher-quality European, Mexican, or South American matches on cable TV. How many soccer enthusiasts—let alone sports fans in general—know that D.C. United is playing the Kansas City Wizards for the 2004 MLS Cup? More sobering, how many care? If playoff attendance is an indication, the answer is: not many. It was down by nearly a third in some venues compared with the regular season.

What's more, the league's emphasis on controlling all player contracts and limiting international players to three per team has produced mostly uninspiring parity. All but two teams make the playoffs, rendering the regular season meaningless. "We have a responsibility to in-

ject much more excitement into the play," says Alexi Lalas, general manager for the San Jose Earthquakes and an ex-MLS player and U.S. National Team member.

That won't be easy, but the time may be right. Purse strings can be loosened without busting the bank as long as some changes take place. The league should break up its single-entity ownership model that sells operat-

Bend it Like MLS

The league has scored some goals recently:

WON a \$100 million sponsorship deal with adidas

IS EXPANDING from 10 teams to 12 next season

LANDED top Mexican club Chivas as one of the new teams

SAW ATTENDANCE rise modestly

Data: Sports Illustrated

HEADS I WIN
Players like Adu
draw crowds
—and receipts



ing rights rather than outright franchises. As it works now, the owners share equally in gains and losses, and the league controls player allocation to the teams, which hardly helps them create a local personality. Sure, it creates parity, but who cares if every team can win the MLS Cup in the same season? The best antidote to parity is letting investors own their franchises.

The league could use some owners with egos who are willing to spend to compete. A salary cap would stop things from getting out of hand.

Today's league is essentially bankrolled by three billionaires willing to sustain losses to keep it going: Phil Anschutz, Lamar Hunt, and Bob Kraft. They believe that soccer will catch on and make money. But so far, only one team, the Los Angeles Galaxy, has ever made an operating profit—a tiny one last year.

Garber also needs to ease the league's restriction on foreign players and do a better job of marketing international stars. Imagine if we had a couple of David Beckhams on each team. We'd be talking a little more about the MLS," says Jeffrey Bliss, president of Javelin Group, a Washington

Only four teams should make the playoffs, not eight

ries, National Football League games, and college gridiron games.

If nothing else, the MLS has proven its ability to survive. Under the shadow of football, basketball, and baseball, it has developed a modest army of supporters, built a business model dependent on leveraging marketing and stadium assets, and provided a place for U.S. players to develop and showcase their talents. Now the league is welcoming Chivas, Mexico's most popular and successful soccer club, which will form a team in Los Angeles as one of the two new franchises. "What Chivas brings to the U.S. is a Latino style of play, full of passion and intensity," says Chivas President Antonio Cué. That's just what this league needs. ■

sports-marketing firm. Obviously a superstar like Beckham at the height of his career commands more money than the MLS can afford, but as top players start to fade, they could bring their star power to America. "Individual owners could offer a player like Beckham a chunk of equity or a player-management position," says Bliss.

The American sports fan knows quality: When Manchester United comes here, the storied English soccer club sells out 60,000 seats in hours. Even the defunct North American Soccer League filled more seats than the MLS. That's simply because fans knew the quality of play was strong, in part because the league recruited such international stars as Pelé and Franz Beckenbauer, albeit in their twilight years.

Garber also should change the playoff structure to make the regular season more meaningful. Four teams ought to make the playoffs, not eight. That would give players the incentive to dribble and tackle harder during the season. Condensing the playoffs would also avoid competition with the World Se-

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The Online AD SURGE

Brand advertising online has taken off—and it's shaking up Madison Ave. **BY STEPHEN BAKER**

IN THE GOLDEN AGE OF TV, THEY CALLED THEM ROADBLOCKS.

Advertisers mounted such visual barricades by placing the same spot at the same minute on the three big networks. That way, the ad would blanket the entire medium, collaring viewers whether they were tuned to Lawrence Welk, *Dragnet*, or Uncle Miltie. The roadblock was a simple but powerful approach—and near impossible to pull off in today's fractured TV market.

But who said a roadblock had to be on TV? A year ago, Ford Motor Co. executives unveiled a roadblock on the Internet to promote their F-150 truck. On the day of the launch, Ford placed bold banner ads for 24 hours on the three leading portals—AOL, MSN, and Yahoo! Some 50 million Web surfers saw Ford's banner. And millions of them clicked on it, pouring onto Ford's Web site at a rate that reached 3,000 per second. The company says the traffic led to a 6% jump in sales over the first three months of the campaign. Naturally, more Internet roadblocks have followed, most recently with the Oct. 25 launch of the F-500 sedan. Says Rich Stoddart, Ford's marketing communications manager: "We've proved we can leverage the Web for the mass market."

Ford and everyone else. Advertisers are seeing that the top few Web properties now reach true mass audiences. Each of the three biggest portals attracts 70% of the Americans online to its properties monthly, according to comScore Networks, a traffic tracking organization. Demand for this prime real estate is so strong that there isn't enough to go around, and prices to advertise are soaring. A year ago, media buyers could land discounted space on the home pages of major portals for between \$100,000 and \$180,000 per 24 hours, say buyers. Now, the cost is reaching \$300,000. Forget about discounts. If advertisers are lucky enough to land the space, they often must agree to spend an equal amount elsewhere on the portal. Facing this traffic jam at the top sites, advertisers are jostling for spots throughout the Net. "A few years ago, it was kids with green hair selling ads," says Gary Stein, an analyst at Jupiter Research. "Now Internet ads are mainstream, and part of every company's media buy."

Why the change? The Internet is growing up. Broadband connections now reach more than half of American households, including the lion's share







More power to you

of the prosperous ones. Although the Internet still takes in only 4.3% of U.S. advertising revenue, surveys indicate that it accounts for 14% of America's media time. And that's not including those who are Web-surfing at work—a major audience for advertisers. Smitten by the growing reach and power of the Net, blue-chip advertisers are stretching far beyond the cramped text ads on search engines that have turned Google Inc. into a global sensation. Now advertisers are packing online ads with music and color video, just like those on TV. They're looking to the Web to build brands.

The result is a surge in growth that's extending from Madison Ave. to the West Coast campuses of Yahoo! and MSN. While the overall ad industry grows at a respectable 7.7% a year, Internet ads are galloping ahead at a 28.8% clip. New York consulting firm eMarketer predicts online advertising will reach \$9.3 billion this year—\$5.4 billion of it in brand ads. "It's a great time to be alive in this industry," enthuses David J. Moore, chief executive of 24/7 Real Media Inc., an ad agency.

For anyone who recalls the soaring expectations that preceded the Net advertising crash earlier in the decade, even a touch of euphoria is grounds for serious heebie-jeebies. Last time around, many of the most enthusiastic advertisers—the cash-happy dot-coms themselves—dropped dead. From 2000 to 2002, Internet advertising plummeted 25%. But something is decidedly different this time. Since the bust, the industry has pieced together the technology—from video delivery to customer tracking—to make good on the shining predictions of the boom. The Net is winning over mainstream advertisers with its computational precision. It delivers hard, quantifiable results measured in clicks and sales—down to the penny. In the process, it's turning advertising from an art into a science.

Does this mean the Internet is going to vacuum up the world's advertising dollars? No, but it'll angle for its fair share. Some of the Net's market grab will come from easy pickings, such as Yellow Pages and direct-response mail—fields where Internet search delivers unmatched efficiency. Brand advertising, meanwhile, will probably come straight from the hide of TV, billboards, and print media. Ford, in line with other auto makers, has moved 10% of its ad budget online, and the number is on the rise. Joanne Bradford, MSN's chief media revenue officer, expects other industries to follow suit, with online accounting for 8% to 12% of the advertising outlay by decade's end. Within two years, online advertising is projected to reach \$13.8 billion, motoring past the slower-growing magazine industry, according to Kagan Research LLC in Monterey, Calif.

Tangle of Complexity

THE IMPORTANCE OF Internet advertising extends far beyond the numbers. Now that advertisers have their hands on a tool that measures an ad's effectiveness, they're starting to press other media for similar accountability. It's a process sure to cause disruptions. Take TV. For decades, Nielsen Media Research has been providing reports on how many customers watch a specific program. But in a nation full of TiVo Inc. zap-

pers and channel surfers, how many are actually seeing the ads? Nielsen is now rolling out technology that measures precise minute-by-minute data in local markets. And it's also working with TiVo to survey ad viewership among TiVo users. These steps bring TV a step closer to Internet-style accountability. But if the results show that viewers are skipping ads, TV's economics could take a beating. "It starts to shift the playing field," says Douglas McCormick, CEO of iVillage Inc. and a former cable-TV exec. "Internet [costs per thousand viewers] are going to start looking a lot more attractive."

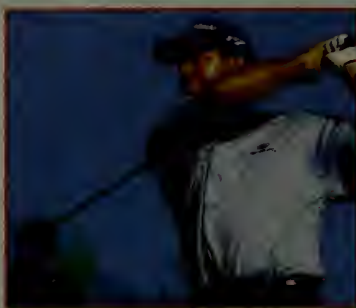
In fact, the Net is helping break down walls that traditionally divide different media. More and more, publishers are delivering selected customers to advertisers, and reaching customers across a host of media, including the Net. Instead of appearing in a certain show or time slot, their ads are coupled with subject areas, such as health or sports. ABC News, for example, delivers subject-specific ads to TV, the Net, and cell phones. Advertisers want "to reach consumers, wherever they are," says Alan Ives, vice-president for sales at ABC Interactive. "They aren't buying a network anymore."

This new world of advertising is bubbling with innovations, many of them blending advertising with content or other goodies. Weather.com, for one, urges the public to download a free weather bar that links up to a host of advertisers, from Scotts, the lawn-care company to American Express. And on Nov. 9, Amazon.com and J.P. Morgan Chase announced a venture to produce short films on the Amazon site. Customers who use an Amazon Visa card to buy items advertised in the movies will get a 5% discount.

All of this innovation creates a tangle of complexity—and simplifying it represents a growing challenge for the industry. While ad agencies can snap up 30-second spots on *Monday Night Football*, the Internet offers almost infinite options. First, advertisers have to pick from a fast-growing number of formats, from skyscrapers that crawl up a page to rollovers—ads that expand as the mouse runs across them. Then they have to figure out on which of the thousands of commercial sites to run the ad. And they must decide whether to orchestrate the campaign to hit people with different ads at work and at home—or maybe arrange a succession of ads, so that a customer's first viewing introduces a product, and the second provides details. "The complexity can be a barrier," says Yahoo's chief sales officer, Wenda Harris Millard. She says Yahoo offered 700 different ad forms when she arrived three years ago. It's down to a fraction of that now, but it remains a lot more complicated than old-fashioned TV or magazine buys.

Here the big players have an outside advantage. They can sell Internet ads as part of a bigger package. CNN, for example, sold pricey sponsorships for Election Day coverage to companies, such as Samsung and DHL. The condition? Sponsors had to advertise on TV and the Web. While CNN's TV coverage was swamped by rival Fox News, the exposure on the Web page more than made up for it. Over that 24-hour period, CNN.com bested the competition with a dizzying 650 million visits.

Already, advertisers are busy linking their Net promotions to offline campaigns, from newspapers to TV. In the most recent



ACING the Speed Test

When TaylorMade Golf used Internet ads to promote its new R7 driver during the U.S. Open in June, things couldn't have gone better. As long shot Retief Goosen took over the field using the R7, the company adjusted the banner ads on the PGA's highly trafficked site to match the ongoing drama. The result? A boost in visits to TaylorMade's site, with 11% of the people coming directly from the banners on the PGA site.

Super Bowl, for example, Mitsubishi Motors bought a 30-second ad. It enticed viewers to visit its Web site to see what happened when a Mitsubishi Galant faced off against a Toyota Camry in a crash test. In the following six hours, some 11 million people visited the site. Many of them provided their e-mail addresses, watched the 50-second video, and clicked the tires in the car company's virtual lot. Such visits are critical, especially for the auto industry. Why? Studies show that shoppers, punching away at search engines, spend an average of five hours researching cars online before setting foot in a showroom.

'Toe in the Water'

IT WAS THE SUCCESS of search-based advertising that breathed life back into the industry following the dot-com collapse. Led by Overture Services—now a unit of Yahoo—and later by Google, the search engines delivered a breakthrough innovation. They interpreted the key words typed in by customers as requests for products and services. And they auctioned the rights to place text ads alongside search results to any company or individual that was interested. The offer has been irresistible: Advertisers paid their bid, be it a penny or a dollar, only when a customer clicked on their ad. Paid search grew from a mere cipher in 1999 into a \$3.9 billion business, according to eMarketer. "Search became a way for marketers of

all stripes to dip their toe in the water," says Ted Meisel, president of Yahoo's Overture Division.

The question is whether the search industry will continue to pace the growth of Internet advertising. eMarketer predicts that growth of such search ads in the U.S. could slow from 55% this year to 19% in 2005. This poses little problem for Yahoo, a powerhouse in both arenas. But Google risks missing out on growth in brand ads. The reason? Advertisers and agencies traditionally separate the direct-marketing teams, which feed into search, from the creative and brand teams that oversee display ads. For now, Google is attempting to bridge the gap by developing ads with images and pictures to accompany search results.

The rush toward display advertising online is similar to the rise of cable TV a generation ago. Until the early 1980s, advertisers saw cable mostly as a direct-marketing tool for niche products, from miraculous vegetable choppers to belly-busting exercise machines, all of them accompanied by a prominent 1-800 number. But in 1982 an advertising executive named Ted Bates proposed a so-called 5% solution. He noted that with half of America's homes cabled, the industry was reaching the scale of a mass market. Advertisers would see substantial gains, he predicted, if they shifted just a nickel from every budgeted dollar to cable from the networks. It paid off. Cable stormed into brand advertising—and is positioned to overtake the broadcast networks within two years, according to eMarketer.

Now Net publishers and ad agencies are pushing their own

SPREADING the Word on the Net

Online advertising is growing at a sizzling 29% rate, to \$9.3 billion this year. Here's why:



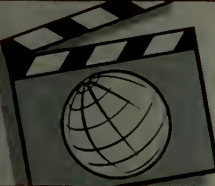
SEARCH WORKS

Google and Yahoo! have demonstrated the power of the Web by using customers' search queries to connect them with advertisers. This combination fuels a search industry expected to hit \$3.9 billion this year.



CUSTOMERS ARE ONLINE

More than half of American households have always-on Net connections. And the Web reaches millions at the office. The BigThree portals—Yahoo, AOL, and MSN—reach a combined 50 million a day—twice the TV audience of a World Series game.



VIDEO ROCKS

The adoption of broadband, which can handle video, lets advertisers put TV-like ads online. Longer spots by BMW and Adidas have reached cult status. As demand for video soars, portals sell choice slots in advance, much like TV's up-front sales.



FEEDBACK IS INSTANT

Marketers and online publishers have tools to track an ad's performance in real time, allowing them to make quick adjustments if customers aren't clicking. This turns the Net into a vast marketing lab. And as video grows, it becomes a test bed for TV ads.



CUSTOMERS LEAVE TRAILS

It was an empty promise during the dot-com days, but now advertisers have the technology to follow customers, click by click, and to hit them with relevant ads. The upshot? No wasted money peddling dog food to cat owners.

10% solution. And they have the ammo to make their appeal. Recent case studies by the industry's trade group, the Interactive Advertising Bureau, showed that while TV spreads the word, the Net can drive home the particulars. One case covered Universal Studios' 2002 DVD release of *ET, the Extraterrestrial*. The studio spent 94% of the budget on TV, nearly 6% on banner ads, and less than 1% on animated ads that floated at the top of Web pages. The result? While most viewers learned of the offering on TV, the animated ads reinforced a key message. Among pure TV viewers, 39.4% learned that the DVD contained never-before-seen footage. But of those who saw TV and the animated ad, the number rose to 48.1%. The study's conclusion: Universal would have fared better by reducing TV by about a quarter and lifting the animated component to 25%. Universal declines to comment on the study.

Video is the latest rage in Net advertising. It represents 11% of online spending, says Jupiter Research. And advertisers are budgeting for more. Take brokerage TD Waterhouse Group. In addition to search and banner ads, the company is running 30-second online videos with *Law & Order's* Sam Waterston. This will contribute to a 42% hike in the company's Internet spending in the next year, says Senior Vice-President Stuart Rubinstein. "Full-motion video is the perfect vehicle," he says.

Tight Squeeze

THE BIGGEST TROUBLE with online video is a shortage of slots for it. While demand grows, much of it is focused on the Net's biggest sites, the home pages of the major portals, along with their finance, sports, e-mail, and auto sites. It adds up to perhaps two dozen pages, all of them run by the giants of the Web. While smaller targeted sites reach niche audiences, most of the crush for branding campaigns is for megasites—and many advertisers get crowded out. "We called MSN to run some video for Adidas," says Sarah Fay, president of Carat Interactive Inc., a Boston media buyer. "They gave us one day in November, and it was on a weekend." The squeeze is so severe that advertisers in the hottest segments of the market—autos, finance, and entertainment—are gobbling up prime video slots months in advance. Within a year or two, industry insiders expect this buying to evolve into an Internet version of the TV industry's annual up-front sales.

The portals are taking advantage of the hot video market to funnel advertisers toward thousands of their less-trafficked pages. Increasingly, they're bundling prime spots into package deals, which include more obscure placements—on pages for foreign-language studies or artisanal cheesemaking. MSN is even offering advertisers who venture into these digital hinterlands a hand in developing new and innovative advertisements (page 82). MSN's



GOLDEN OPPORTUNITY MSN's Bradford says online may get 12% of ad funds by 2010

Bradford says varied locations have different uses. The home page serves a message to 20 million users a day while placements in back pages reach niche audiences sometimes numbering only in the tens of thousands.

Advertisers have plenty of room for video on their own home pages. And much of their ad effort, on and offline, is focused on getting Web surfers to drop by. Many TV watchers these days sit close enough to a computer to type in a Web address or "Google" a site without moving from the couch. During golf's U.S. Open in June, TaylorMade-Adidas Golf ran TV ads promoting its new R7 driver. Traffic on the site jumped 22% in the hour after each ad, says Jason Woodmansee, the company's director of global eMarketing. Once visitors came to the site, they not only clicked through videos showing the club in action but

also located nearby stores and signed up for e-mails. That way, the company used the Net to turn a broad TV audience into a vast collection of individual relationships.

But how to reach customers with just the right message? Increasingly, advertisers are tracking them down. With a technology called behavioral targeting, a Who's Who of publishers, from NYTimes.com to BusinessWeek.com, use systems that quietly map the click path of registered visitors to their site or network. These programs do not accumulate personal data on the user. But using digital cookies dropped into each visitor's browser, they focus on behavior. For example, the system knows which site an anonymous Web surfer comes from. It also keeps tabs on how much time that reader spends looking at a particular article, and which ads he or she clicks on. Instead of asking consumers loads of questions about themselves, says Eric Christensen, general manager of Belo Interactive in Dallas, "we can now infer from their behavior on the site. That has been a big change in the last year."

Publishers follow their customers gingerly, knowing they run the risk of inciting a privacy backlash. Web surfers, under siege from spam and torrents of pop-up ads, are primed to fend off bothersome ads. And previous attempts to track customers have run into legal tangles. Ag-



DRESSING UP Instant Messaging

Young people spend hours staring at instant messenger boxes as they chat online with their friends. Now advertisers are urging them to download branded decorations, called skins, that they can use to outfit these boxes. With a skin from Purina, dog lovers get a virtual pet to play with and feed. The extra payoff for advertisers? Users share these branded skins with their chat buddies, adding exposure.

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Where e-commerce is safe commerce.
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gressive consumer profiling by DoubleClick, a once high-flying Net ad company, sparked a lawsuit four years ago by 10 state attorneys including New York's Eliot Spitzer. DoubleClick, which set out to build databases combining personal info with Web-surfing habits, retreated on its plans and settled the lawsuit. It failed to recover its market leadership, though, and now is up for sale.

But while DoubleClick fades, scores of companies are storming into the growing world of online advertising. They range from tech outfits that create new forms of banners and sky-

scrapers to advertising startups that tie together vast networks of publishers, from fishing sites to political blogs. "Net advertising is only nine years old, and everybody's just now getting started," says Gurbaksh Chahal, CEO of BlueLithium, a San Jose (Calif.) advertising company. Those who manage to climb atop the Internet's advertising wave are in for a wild ride. ■

BusinessWeek online For a story on how Rite-Aid and other companies are using the Internet to reach teenagers, please visit www.businessweek.com/magazine/extra.htm

Online Ads: Ready For Their CLOSE-UP

The 30-second television ad. To the creative directors at Madison Avenue's largest ad agencies, it is their focus, their world, their definition of

happiness. Such spots are the means to glory, whether it's from a showy debut during the Super Bowl or a prestigious award at the annual Cannes Advertising Festival. Online ads, on the other hand, have largely been ignored. Top agencies often outsource them to specialists or give them to separate in-house staffs, often banished to a geeks' corner. This "online ghetto" syndrome may be one reason that the vast majority of video ads now running on the Net are mere hand-me-downs from TV. Some of the best creative minds just haven't been into the Net.

Microsoft Corp.'s MSN is trying to change all that. The Web portal recently asked four ad agencies known for their unconventional advertising to experiment with new forms of online messages for their clients. The draw? MSN, which attracts more than 350 million visitors a month to its portal and e-mail service, is giving away millions of dollars' worth of extra space and technical support, as long as the advertisers buy some ads up front. The agencies' efforts are just now hitting computer screens, beginning with a campaign for consumer-electronics giant Sharp Corp. In return for giving away ad space deep inside the MSN site and on its home page, MSN hopes the program will persuade the biggest agencies and their marquee clients to direct more of their creative energy toward the Net. At the least, says MSN's marketing director, Eric Hadley, "I want us to be associated with breakthrough brands."

Hadley is stacking the odds in his favor. The four agencies he signed up for his

initiative, called MSN Creative Connections, are respected for their innovative online creations. First off the blocks is Wieden & Kennedy. In October, it launched a moody mystery online and through TV ads to hawk Sharp's new \$10,000 Aquos line of liquid-crystal-display TVs. The TV ad opens with the scene of a man swimming in a pool gazing up at his lover in a chateau window. An orange Volkswagen Karmann Ghia suddenly careens into the pool.

The TV spot never even pitches the pricey set and, instead, is designed to draw viewers



WEB SPOT FOR SHARP TVs MSN aims to wake up Mad. Ave.

to the Web. There, they can discover that the man in the pool is part of a larger mystery, with multiple story lines and blogs about the characters. Embedded within the mystery's clues are invitations to learn more about the Aquos. "Whereas people are zapping most TV advertising, the Net is amazing for drawing people in, if our ingenuity is up to it," says Ty Montague, Wieden & Kennedy's chief creative officer on the campaign. In the first week, the site got 1.3 million page views from visitors.

The Microsoft unit has offered its technical expertise to help shape content

and improve the look of Sharp's online work. It also intertwined its content with Sharp's—providing a link next to an image of the sinking VW to an MSN article about how to escape from a submerged car.

The campaigns of the other three agencies will hit the spotlight during the next few months. New York's Deutsch Inc. put together a campaign for Revlon Inc. that lets consumers make Web movies featuring their own digital photos. Miami agency Crispin, Porter & Bogusky is helping Burger King Corp. position its chickenfight.com ads as entertainment rather than just ads. Chickenfight.com, a fowl version of Rock 'Em Sock 'Em Robots, will be presented as a tab at the top of MSN's Fox Sports page, along with tabs for the NBA, NFL, and NASCAR. "It creates a sense of credibility that we're a content provider," says Russ Klein, Burger King's chief marketing officer.

Not all the firms MSN is working with are trying to sell more burgers or makeup. Paul Lavoie of the Toronto agency Taxi is using MSN's offer of \$1 million in free media to benefit Covenant House, a charity that helps street kids. Lavoie says his team is exploring several options for the campaign. One possibility is to create fake home pages for MSN and other sites that would digitally melt away, revealing a message like "Imagine what it's like to have no home." For a charity that draws most of its support from older widows, Lavoie says, reaching a broad, cyber-savvy audience is priceless.

Agencies don't need MSN to tell them they have to devote more creative talent to cyberspace. What they have found is that sparking people's interest online is as challenging as keeping them engaged when they're watching TV with a remote control.

—By Diane Brady, with David Kiley, in New York



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■ Guatemala is brimming over with opportunities in open market sectors

Guatemala

OPENING CENTRAL AMERICA FOR BUSINESS

AS HOST TO THE FELABAN ANNUAL ASSEMBLY THIS WEEK, GUATEMALA SHOWS ITS COMMITMENT TO AN OPEN MARKET ECONOMY, WHILE INVESTOR CONFIDENCE CONTINUES TO GROW.

With the final touches set for this week's Latin American Bank Federation (FELABAN) annual assembly meeting in Guatemala City, the Central American republic has been able to survey the future from the vantage point of a player in the larger regional context. The government, led by President Oscar Berger, recently elected by a majority of his 14 million countrymen, is sweeping out the darker corners of the previous administration's legacy, cleaning up the public sector, fighting corruption and consolidating an open market economy with stronger regional ties.



■ Haroldo Rodas Melgar
Secretary-General, SIECA

Hosting the FELABAN Assembly (21-23 November) is but the latest example of Guatemala's leading role in the cohesion of the Central American markets, coordinated by the Secretariat of Central American Economic Integration (SIECA), a 40 year-old institution that has come of age in the current global economy. SIECA's main objective, according to Secretary-General Haroldo Rodas Melgar, is to reach a trade agreement between Central American countries that will end local tariff barriers and consolidate

the region's international market share. "Ninety-two percent of all products and services are already harmonized tariff-wise within the five Central American markets", says Mr Rodas, in reference to Guatemala's free-trade partners: Mexico, Costa Rica, Honduras and Nicaragua. The remaining percentage are the object of current talks encompassing products such as oil, medication, metals and agriculture, including the two most sensitive of all: coffee and sugar.

Despite the arduous nature of the negotiations, the Secretary-General is optimistic: "These are issues which must be settled to negotiate the Central American Free Trade Agreements (CAFTA) with the United States", he says. Neighboring El Salvador has recently joined the bandwagon, signing a border agreement with Guatemala that practically closes regional participation in the economic bloc.

While the country's international market role is hashed out in multilateral conclaves, internal economic engines are being fine-tuned to support the rigors of global competition. Minister of Economy Mario Cuevas Lueza is in charge of applying the new administration's economic guidelines. "First, we must become more competitive by generating clusters in the productive sectors", says Mr Cuevas.

Tourism, banking and telecoms are some of the major growth sectors undergoing major structural adjustments to attract investment and generate income required to alleviate stark social inequalities. Foreign Affairs Minister Jorge Briz Abularach states: "We know jobs and growth are generated with international support, from the private sector". The vision of Guatemala's future is a complicated balancing act but the new administration seems ready to walk the line.

FINANCE

In the past two years, Guatemala has taken firm steps to strengthen its national financial system, enacting legislation that provides the tools to develop and supervise a modern banking sector. This means not simply complying with international banking standards, but to someday bring a single monetary policy and perhaps even a single currency to the Central American economic bloc. For these reasons, the Bank of Guatemala applauds the new administration's regional integration efforts. "Central America now has the chance for a political, monetary and fiscal harmonization process", says Lizardo A. Sosa, Presi-



Your comfort
is our business



REAL

INTERCONTINENTAL
GUATEMALA



TORCHBEARER
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We know what it takes



dent of the Bank of Guatemala. For a country with a GDP per capita half that of Brazil, Argentina and Chile, a larger regional market would put paid to a history of strife, leading the consolidation of economic sectors other than agricultural, which currently accounts for a full quarter of the country's GDP.

INDUSTRY

In contrast to the previous administration's relations with the private sector – referred to as "confrontational" – by many, President Berger's government is determined to help Guatemalan business take the country to new heights. The Guatemalan Chamber of Commerce, headed by Jaime Arimany, works every day to this end, providing support to local companies who are considering export markets. Mr Arimany has no shortage of examples to illustrate the *Made in Guatemala* brand, with bona fide successes like Pollo Campero, the wildly popular fried-chicken chain that serves typical Guatemalan flavor throughout Central America, Mexico and the U.S., or Industrias Licoreras de Guatemala (ILG). The latter produces distilled beverages with major market shares throughout Central America and exports to Europe, the U.S. and Asia. Born from the fusion of various family-owned distilleries during the seventies, ILG is the region's foremost producer of alcoholic beverages, from local quetzaltecas to award-winning rums. It even sells alcohol as a prime material to external markets for making perfumes and liquors. With the ISO 9001 Certification recently awarded to the company's distilleries, external demand has surged, giving ILG a 60 percent share of the market in neighboring El Salvador and 35 percent in Honduras.

In Europe, Asia and especially the U.S., the company's flagship product is Zacapa Centenario rum, increasingly present in liquor stores in Miami, New York, Chicago and L.A. Given the success of the Zacapa brand – five-time winner of the International Rum Festival – ILG's investment plans revolve around the years-long aging process that gives the rum its color and body. Roberto García Botrán, president of the



■ Lizardo A. Sosa, President, Bank of Guatemala



■ Marcos Cuevas, Minister of Economy

ILG group, says: "We have been investing heavily in aging for over ten years. In the last two years, we have doubled investment and this year decided to triple it to cover the demand of specific export markets". The aging process is the distinguishing mark of quality

rum, and is set to strict standards. "Of course it's a limiting factor", he admits, "but at the same time it opens a niche in the exclusive market". The group has also diversified into different areas, such as the financial sector, the mineral water business and the ownership of Central America's largest bread-leavening factory.

In the period following the electoral victory of President Berger, ILG is cautiously optimistic "Guatemala is in a transitoal period, coming out of the most conflictive government of our history", says Mr García, "President Berger has the support of the business sector; we are willing to cooperate with his task force as producers and as citizens". This climate of goodwill is vital to the ongoing trade negotiations with the U.S., although García points out that ILG's commercial relations with North America are already well-oiled within the framework of the Caribbean Basin Trade Partnership Act. Future trade agreements will help consolidate the market and open new investment opportunities for the region's companies, although some products are missing in the quotas assigned to the region. "Guatemala was not assigned an export quota for alcohol fuel – a product with a great future in terms of contamination issues and with oil prices rising. We were excluded for not having a history of exporting this product to the U.S."

While trade agreements can bring export opportunities for local companies, they can also bring stiff competition when foreign products hit local markets. Businesses with dominant market shares brace

*The best pearls in the world
come from Japan.*



*...and the best rum in the world
comes from Guatemala.*



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Tel.: (502) 470-9696, Ext. 583
exports@rumgt.com

For five consecutive years Ron Zacapa Centenario has been awarded as the Best Rum in the World, therefore it was the first and only rum chosen to inaugurate the International Rum's Hall of Fame, at the International Rum Festival.

themselves for the global onslaught, some with more confidence than others. Cementos Progreso S.A., Guatemala's leading cement producer, is ready to take on all comers with its ISO 9001:2003 Certification and more than a hundred years' history in the sector. "We supply all segments of the local market with cement, lime and concrete of the highest quality standard", says company director José Miguel Torrealba.

The company was founded in 1899 with a capacity of 100 sacks a day. Now its output is three million tons a year. Constant investment in technology has made the company one of America's most developed producers, which is about to be awarded another Certification: this time the ISO 14000. Cementos Progreso continues to implement the vision it was founded on: 'sharing dreams and building realities'.

COMMUNICATIONS, TRANSPORT AND INFRASTRUCTURE

High on the new administration's priority list is to improve and continue development of the country's infrastructure. Minister of Communications, Infrastructure and Housing, Eduardo Castillo Arroyo, is in charge of advancing vital projects like the proposal for a third international airport to boost tourism and the Guatemalan section of the Puebla Panama Plan. This pan-American transport artery of products, information and energy will cross Central America from Mexico all the way down to Panama. On top of this, the recent surge in telecommunications requires legislative redefinitions to regulate the sector more effectively.

The Pacific port of Puerto Quetzal, founded 25 years ago, lies 70 miles south of Guatemala City and is one of the largest ports in the region. Edgar Sandoval Martínez, President of the Puerto Quetzal Company, points to the port's mixed private/public status as one of its most important defining characteristics. "Private companies can operate in the port area", says Mr Sandoval, "while the port itself is an important economic generator". Both Puerto Quetzal, and its sister port, the Santo Tomas de Castilla on the Atlantic, are working to devel-



■ The country celebrates a rich Mayan heritage

op the enormous tourist potential that exists on both sides. One attraction of the region could be sport fishing of sail fish, one of the fastest catches the ocean has to offer.

TOURISM

Guatemala is a territory blessed with great natural beauty and a diversity of tourist destinations. As the center of the ancient Maya empire, sensational ruins and living vestiges of indigenous culture abound. The Guatemalan Institute of Tourism (INGUAT) highly recommends the Maya ruins at Tikal, the Chichicastenango marketplace, and the colonial remains of Antigua, capital of Guatemala until 1776. The current capital, Guatemala City, is a major tourist and business destination and therefore, home to the country's finest hotels, such as the Radisson Hotel and Suites and the Real Intercontinental.

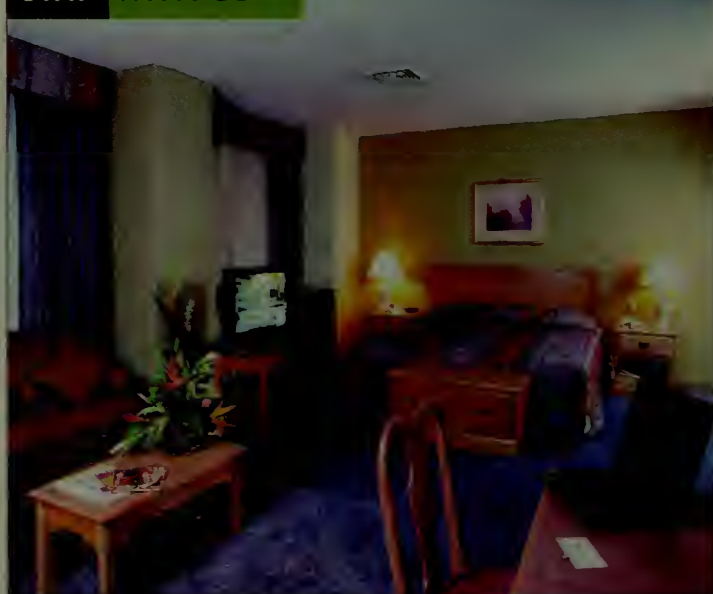
Located in the financial district of Zona Rosa, the Radisson boasts spectacular views of the city and the surrounding mountains. Guests receive personalized attention when they arrive at La Aurora International Airport. The hotel offers five spacious meeting or banquet rooms for up to 300 people.

Opened in 2000, the Guatemala City Real Intercontinental has set a new standard for service-oriented luxury hotels. General Manager José Miguel Belloni sums up the hotel's philosophy: "Our objective is to offer more than our guests are expecting", he says. So far, the pursuit of excellence has garnered the hotel two Torchbearer awards, given by the Intercontinental Hotel Group in recognition of the highest standards of excellence in all operational aspects. Set in the trendy Zona Viva district, the hotel has 239 rooms and 30 executive suites, and focuses on the business traveler, although they also take in single-night tourists on their way to and from cultural sites. Despite strong competition, the steps taken by INGUAT to promote fairs and congresses will soon provide a steady stream of guests to enjoy the exceptional service that the hotel has made its trademark.

Business Focus

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Drifting Back To Earth

Third-quarter profit growth, while respectable, slowed from its sizzling pace

THE TALLY IS COMPLETE, and it's now official: Corporate profits have returned from the stratosphere. Earnings at the 900 companies in *BusinessWeek's* Corporate Scoreboard rose 19% in the third quarter from the previous year—a smart pace, but decelerating from a 41% hike in the second quarter. And if it weren't for an impressive showing by the energy patch, the

slowdown would have been even more evident. Take away Exxon Mobil Corp. and other big energy companies, and the profit increase slowed to 16%.

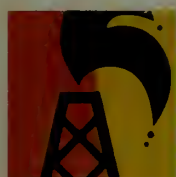
Any double-digit profit rise is nothing to sneeze at, of course. But this is the first time in six quarters that earnings gains from the previous year failed to top the 20% mark. Blame the cooler economy and rising costs: the cost of money, by way of higher interest rates; the cost of labor, in slowing productivity; and the cost

of basic commodities, including oil. In fact, things looked worse at the start of the third quarter, when analysts had forecast only a 13.9% earnings rise from continuing operations for the Standard & Poor's 500-stock index, according to Thomson First Call. Now, senior analyst Gint Rimas says growth will probably be about 17% after pockets of strength—in energy, materials, and technology—unexpectedly emerged during the quarter.

COOLING DOWN

THE DIFFERENCE between *BusinessWeek* and First Call earnings is that Scoreboard profit numbers are based on reported income from continuing operations before extraordinary items, as defined by generally accepted accounting principles. That definition includes such items as asset sales and charges for lay-offs. Thus, the 19% increase for third quarter Scoreboard profits would be 26% if you factored out \$38 billion in one-time items. And the 41% rise in second-quarter profits was helped by the fact that some big companies were coming off huge 2003 losses or acquisition-based write-offs. First Call's numbers, on the other hand, are based on analysts' estimates and exclude certain unusual items.

Any way you cut it, things were bound to slacken given the deceleration in the



Third-Quarter Winners and Losers

Oil companies provided most of the oomph for the quarter. But plenty of other blue chips joined in, from Microsoft to Pfizer and Wal-Mart.

INDUSTRIES

Leaders		Laggards	
Percentage Change from 2003's Third Quarter		Percentage Change from 2003's Third Quarter	
INTERNET SOFTWARE & SVCS.	561%	DIVERSIFIED TELECOM SVCS.	LOSS
ENERGY EQUIPMENT & SVCS.	401	AIRLINES	LOSS
CONTAINERS & PACKAGING	348	AUTO COMPONENTS	LOSS
PAPER & FOREST PRODUCTS	173	MEDIA	LOSS
INTERNET & CATALOG RETAIL	121	GAS UTILITIES	LOSS
SEMICONDUCTORS	65	COMMUNICATIONS EQUIPMENT	-80%
COMMERCIAL SERVICES	64	THRIFTS	-29
INSURANCE	60	TRADING COMPANIES	-28
OIL & GAS	51	SPECIALTY RETAIL	-21
MULTILINE RETAIL	50	REAL ESTATE	-21
MACHINERY	45	BIOTECHNOLOGY	-8
AIR FREIGHT & LOGISTICS	40	LEISURE EQUIPMENT & PRODS.	-5
OFFICE ELECTRONICS	39	CAPITAL MARKETS	1
AEROSPACE & DEFENSE	37	ELECTRIC UTILITIES	2
PHARMACEUTICALS	36	BEVERAGES	3
All-Industry Composite		+19%	

COMPANIES

Who Made the Most		Who Lost the Most	
Millions of Dollars		Millions of Dollars	
EXXON MOBIL	\$5,680	AT&T	-\$7,147
CITIGROUP	5,308	MCI	-3,400
GENERAL ELECTRIC	4,051	CHARTER COMMUNICATIONS	-2,529
BANK OF AMERICA	3,764	CORNING	-2,511
PFIZER	3,298	SPRINT	-1,910
CHEVRONTXACO	2,936	BLOCKBUSTER	-1,416
MICROSOFT *	2,901	VISTEON	-1,360
WAL-MART STORES **	2,651	DIRECTV GROUP	-926
ALTRIA GROUP	2,648	DELTA AIR LINES	-646
AIG	2,512	INTERPUBLIC GROUP	-585
JOHNSON & JOHNSON	2,341	QWEST COMMUNICATIONS	-569
CONOCOPHILLIPS	2,011	TEXAS GENCO HOLDINGS	-311
PROCTER & GAMBLE *	2,001	LSI LOGIC	-282
INTEL	1,906	UAL	-274
IBM	1,800	NEWELL RUBBERMAID	-235

* Fiscal first quarter ** Fiscal second quarter

Data: Standard & Poor's Compustat

A Return To Normal

High oil prices and lower productivity restrained third-quarter gains

Profits

+19%

Sales

+13%

Rise in GDP

+3.7%

Profit Margins

+6.3%

economy. Real gross domestic product grew only 3.7% in the three-month period—down from the 4.3% pace Wall Street expected. “Third-quarter profits are a mixed picture of an economy that’s undergoing a transition,” says Stuart A. Schweitzer, managing director and global investment strategist at J.P. Morgan Fleming Asset Management.

Yet even as the economy slowed, strong business spending continued to swell revenues. The machinery, Internet software and services, and computer-chip sectors all recorded sales gains of 20% or more, and electronic equipment and instruments surged 18%. Total Scoreboard revenues climbed 13%—the fourth straight quarter of double-digit gains. Of the 60 Scoreboard industries, 57 had higher revenues, while margins rose to 6.3%, vs. 6% the previous year.

At the top of the earnings heap this quarter were the oil companies—no surprise, given the runup to \$50-a-barrel crude. Boosted by rising worldwide demand and tight supplies, ExxonMobil, the world’s largest energy producer, saw a 56% profit jump, to \$5.7 billion. That ensured Exxon was once again the total profits leader. ConocoPhillips’ earnings shot up 61%, to \$2 billion, on a 34% revenue gain. Getting an additional boost from asset sales and its booming international gasoline refining and marketing business, ChevronTexaco Corp. saw a 50% profits jump, to \$2.9 billion.

Similarly, pricing power and insatiable worldwide demand continued to lift results in the basic materials sector. Steel producer Nucor Corp., for example, was able to raise the average price per ton for its steel and steel products by 87% from the previous year, to \$668 per ton. The higher selling prices, combined with the integration of two newly acquired mills, pushed Nucor’s third-quarter earnings to \$415.4 million, up from \$16 million the year before. Sales more than doubled, to \$3.2 billion. Meanwhile, the continued strength in housing helped drive larger volumes and higher prices for wood

products. At timber giant Weyerhaeuser Co., one-time gains of \$208 million—which included the sale of timberland—pushed profits up 624%, to \$594 million. “Prices had the biggest positive effect on our third-quarter earnings,” CEO Steven R. Rogel told analysts.

Profit gains in the technology sector were respectable but not spectacular. Microsoft Corp. raked in the most profit for the group, making \$2.9 billion, up 11% from the year before. IBM, however, saw a meager 1% increase, to \$1.8 billion. The new breed of dot.commers turned in stronger performances. Yahoo! Inc., for example, saw profits nearly quadruple, to \$253.3 million, benefiting from more ads on its non-search-area sites. And fresh off its initial public offering in August, search kingpin Google Inc. raked in \$52 million, up 154% from its previous-year quarter, thanks in part to strong international sales.

Even with some high-profile product disasters, the drug industry still managed to crank out a 36% profit gain. Merck & Co. took a major hit with the withdrawal of its painkiller Vioxx. Product

returns, the write-off of Vioxx inventory, and the cost of the withdrawal itself all helped push Merck’s income down 29%, to \$1.3 billion. But big rebounds at other pharma houses more than made up the difference: Without the drag of costs associated with its Pharmacia acquisition, Pfizer Inc., boosted earnings by nearly 50%, to \$3.3 billion. And Wyeth swung to a \$1.4 billion profit—up from a \$426 million loss the previous year, when it took a charge related to litigation surrounding two of its diet drugs, Redux and Pondimin.

AIRLINE WOES

MEANWHILE, THE MAJOR investment banks, which appeared to be invincible in recent years, turned in results that were decent but hardly stellar. Mergers and stock offerings remain in the dumps and rising interest rates are making it more difficult for banks to generate big trading profits. Goldman, Sachs & Co., for example, saw a 30% jump in profits from the year before, to \$879 million. But that was 41% less than second-quarter earnings. At Morgan Stanley, income fell by 17%, to \$862 million, in large part because its trading operation bet wrong on rates.

The biggest loser this quarter was

Strong capital spending buoyed revenues



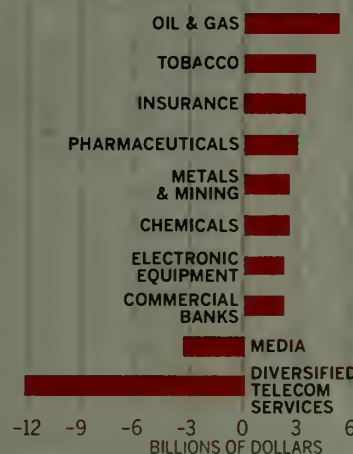
Profits Spotlight

Tobacco, metals, and electronics sprang back from weak 2003 results, offsetting telecom and media woes

Earnings growth slowed from the torrid pace of the previous six quarters, but the quarter’s 19% is a respectable showing—especially when coupled with 13% sales growth. Strong results at oil companies helped a lot. But growth was broad-based, with 48 of the 60 industries making more money than a year earlier. The tobacco, metals, and electronics equipment sectors all sprang back from 2003 losses to post profits in the third quarter. Of the 12 industries that made less money, the worst were media and diversified telecom. Most of media’s woes can be attributed to the \$2.5 billion loss at Charter Communications, while telecom was undone by a \$7.1 billion loss at AT&T, the \$3.4 billion loss at MCI, and a \$1.9 billion loss at Sprint.

Data: Standard & Poor’s Compustat

CHANGE IN AFTER-TAX PROFITS





PROFITS

Nice Tax Break While It Lasted

If corporate profit growth hits a wall next year, as many economists expect, one of the biggest reasons will be the end of a major tax break that was enacted to jump-start the economy in the wake of the September 11 terrorist attacks. In March, 2002, Congress passed a bill that let companies take an immediate bonus depreciation allowance on capital investments such as computers and cars. At first, 30% of the cost of capital goods could be deducted from earnings, and the rate was later raised to 50%. But that bonus is now set to end on Jan. 1.

For corporations, the bottom line is that depreciation write-offs lower the amount of income that is taxable. With business investment on equipment and software projected to near \$1 trillion this year, the depreciation bonus will reduce many 2004 corporate tax bills—though total taxes paid will still rise as a result of economic growth. But a return to the old depreciation schedules will hike the effective corporate

tax rate next year by about one-third, to 30%, says David A. Wyss, chief economist at Standard & Poor's. That change alone will account for \$90 billion of the projected \$113 billion increase in corporate taxes next year (chart).

Businesses with a high proportion of capital spending to sales, such as utilities or telecom, will suffer the biggest tax bite. But Richard B. Berner, chief U.S. economist at Morgan Stanley, says that a survey of the company's analysts shows that within the next six months, telecom, biotech, semiconductors, air freight, railroads, and steel will actually increase capital spending.

Why? Because ultimately, economic fundamentals are the driving force for

spending plans. "Our customers appear to still have pent-up demand," says Rockwell Automation Inc. Chief Financial Officer James V. Gelly. The Milwaukee maker of factory automation equipment says it expects orders to keep growing in the first half of 2005, so Rockwell will ratchet up its own capital spending, mainly on software and computer systems, by 20%, to \$120 million next year. And in September, the Federal Reserve Bank of Philadelphia asked manufacturers in its region about spending plans: Some 56% planned to raise investment outlays in 2005, while 16% said they would cut spending.

The effects of the overall tax boost next year won't hit everyone the same way. Some companies can use previous years' losses to shield future profits. While it plans to more than double capital spending to \$1.5 billion this year Sunnyvale (Calif.) chipmaker Advanced Micro Devices Inc., for instance, has enough losses over the past three years to offset future taxable income.

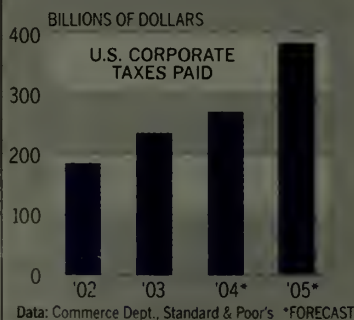
In any case, don't cry for big business. Many companies got new breaks as part of the tax bill passed in October. Congress granted a tax holiday on repatriated earnings, for instance, slashing the rate on foreign profits earned before 2003. The money must be used to pay down debt, to hire new employees, or on capital spending.

Boston Scientific Corp., the Natick (Mass.) stent maker, says it is eligible to repatriate \$1 billion. By some estimates, U.S. companies will repatriate up to \$300 billion in 2005. So as the government takes away with one hand, it's hard at work providing new breaks with the other.

—By James Mehring in New York, with Michael Arndt in Chicago

UNCLE SAM TAKES A BIGGER BITE

With the end of a depreciation bonus next year, U.S. corporations' effective tax rate will rise from 23% to 30%



AT&T, which suffered a staggering \$7.7 billion net loss. The culprit: a \$12.5 billion charge to write down the book value of its land-line network and pay severance for 7,500 workers as it retreats from the consumer long-distance businesses. Sprint Corp. and MCI Inc. also wrote down long-distance assets, resulting in losses of \$1.9 billion and \$3.4 billion, respectively. But telecom equipment makers are emerging from the funk that began with the stock market slump in 2000. Lucent Technologies Inc.'s profits more than tripled, to \$348 million, on the strength of its mobile and high-speed networking businesses.

Higher interest costs are likely to become a drag

Strong cellular phone sales helped push up Motorola Inc.'s net by 313% to \$479 million.

It's not news that airlines are struggling. After months of chopping costs to close the gap with nimble discounters, big carriers got

walloped by soaring fuel prices. As a group, airlines posted a loss of \$1.2 billion. Half of that was generated by near-bankrupt Delta Air Lines Inc., which spilled \$646 million worth of red ink. Once again, one of the few bright spots was low-cost Southwest Airlines, where profits jumped 12%, to \$119 million. Southwest kept costs in check by lowering the ratio of employees to aircraft and by prepurchasing fuel at lower prices.

Don't expect much improvement in coming months. The economy is expected to keep cooling, while high energy and commodity prices will eat into the bottom line. Interest costs are likely to become more of an issue, too. The Fed Reserve was expected to hike its key interest rate by one-quarter of a percentage point, to 2%, on Nov. 10. So analysts are looking for profit growth of 15.3% in the fourth quarter and only 8.9% in first quarter of 2005, according to a First Call survey. Sung Won Sohn, chief economist at Wells Fargo & Co., compares the slowdown to speeders who suddenly see a cop at the side of the road: "We had been traveling at 70 miles an hour. Now we're slowing down to 55. [Profit growth] is back to a more normal pace." Executives and investors will just have to get used to fewer thrills. ■

—By Stephanie Anderson Forest in Dallas, with bureau reports

Third Quarter 2004

A cooler economy and rising costs reined in earnings growth

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO AS OF 11-4	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
ALL-INDUSTRY COMPOSITE	2195605.6	13	6427752.1	13	138296.8	19	443773.0	29	6.3	6.0	14.3	21	1.70
CONSUMER DISCRETIONARY SECTOR COMPOSITE	412909.9	8	1248799.1	9	11093.3	-20	49022.7	22	2.7	3.7	9.8	25	1.33
1 AUTOMOBILES & COMPONENTS													
INDUSTRY GROUP COMPOSITE	121599.3	6	386956.4	7	264.5	-62	7959.8	40	0.2	0.6	10.9	16	1.48
(A) AUTO COMPONENTS													
INDUSTRY COMPOSITE	34655.4	9	110058.4	9	-930.7	NM	490.6	-27	NM	NM	0.7	NM	0.05
American Axle & Mfg. Holdings AXL	841.6	-3	2724.0	-1	36.4	-6	128.2	-11	4.3	4.5	19.0	9	3.33
Autoliv ALV	1382.7	14	4449.1	16	67.3	30	232.9	32	4.9	4.3	13.2	13	3.42
BorgWarner BWA	839.8	16	2636.1	16	44.8	25	150.6	21	5.3	5.0	13.8	14	3.57
Cooper Tire & Rubber CTB	551.4	6	1540.6	15	13.2	-10	24.2	42	2.4	2.8	4.8	29	0.70
Dana DGN	2107.0**	10	6788.0	13	51.0	38	174.0	46	2.4	1.9	10.3	10	1.53
Delphi DPH	6650.0	1	21610.0	4	-114.0	NM	66.0	NM	NM	NM	9.7	32	0.27
Dura Automotive Systems DRR	616.4	11	1909.7	9	-2.7	NM	10.5	-58	NM	0.9	3.0	16	0.55
Federal-Mogul FDM	1511.1	13	4640.6	12	-34.2	NM	-63.6	NM	NM	NM	NM	NM	-2.11
Hayes Lemmerz International HAYZ (11)	523.7	4	1625.2	9	-10.0	NM	-40.0	NM	NM	NM	-7.4	NM	-1.58
Johnson Controls JCI (3)	6756.9	13	20169.3	15	273.0	24	653.0	20	4.0	3.7	15.6	14	4.24
Lear LEA	3897.8	12	12673.9	10	91.7	20	299.2	21	2.4	2.2	17.2	9	6.16
Modine Mfg. MOD (9)	363.6	30	1032.0	23	14.1	226	40.4	71	-3.9	1.5	8.7	21	1.54
Tenneco Automotive TEN	998.0	9	3152.0	11	6.0	50	34.0	17	0.6	0.4	31.7	17	0.74
Tower Automotive TWR	722.3	16	2286.8	9	-20.2	NM	-10.9	NM	NM	NM	-10.8	NM	-0.77
TRW Automotive Holdings TRW	2739.0	8	8825.0	5	13.0	NM	91.0	NM	0.5	NM	8.2	21	0.90
Visteon VC	4154.0	7	13996.0	6	-1360.0	NM	-1299.0	NM	NM	NM	NM	NM	-17.24
(B) AUTOMOBILES													
INDUSTRY COMPOSITE	86943.9	5	276898.0	6	1195.2	31	7469.2	49	1.4	1.1	15.3	10	2.35
Fleetwood Enterprises FLE (8)	727.8	13	2014.9	18	6.7	248	-21.3	NM	0.9	0.3	-6.1	NM	-0.46
Ford Motor F	38996.0	6	126390.0	7	480.0	98	3635.0	129	1.2	0.7	21.3	10	1.43
General Motors GM	44858.0**	3	141691.0	4	440.0	-2	3061.0	7	1.0	1.0	11.0	7	5.39
Harley-Davidson HDI	1378.2**	14	4033.2	10	229.0	20	680.8	18	16.6	15.7	27.9	20	2.89
Monaco Coach MNC	358.9	18	1071.6	27	7.4	19	31.3	180	2.1	2.1	13.4	13	1.41
Thor Industries THO (5)	625.1	48	1697.3	46	32.1	44	82.4	43	5.1	5.3	20.7	17	1.84
2 CONSUMER DURABLES & APPAREL													
INDUSTRY GROUP COMPOSITE	57188.3	15	155627.7	15	3856.2	14	9582.1	21	6.7	6.8	18.1	16	2.79
(A) HOUSEHOLD DURABLES													
INDUSTRY COMPOSITE	35313.6	17	98055.8	17	2179.6	15	6012.9	22	6.2	6.3	19.8	14	3.70
American Greetings AM (10)	391.9	0	1360.0	0	5.9	NM	57.1	7	1.5	NM	8.1	21	1.35
Beazer Homes USA BZH (3)	1211.1	16	3097.0	25	80.1	40	188.6	39	6.6	5.5	20.7	7	17.09
Black & Decker BDK	1282.5	15	3673.0	17	111.3	52	307.4	61	8.7	6.6	32.1	17	5.03

(1) Third quarter ended Aug. 31. (2) Third quarter ended July 30. (3) Fourth quarter and most recent nine months ended Sept. 30. (4) Fourth quarter and most recent nine months ended Aug. 31. (5) Fourth quarter and most recent nine months ended July 31. (6) First quarter and most recent nine months ended Sept. 30. (7) First quarter and most recent nine months ended Aug. 31. (8) First quarter and most recent nine months ended July 31. (9) Second quarter and most recent nine months ended Sept. 30. (10) Second quarter and most recent nine months ended Aug. 31. (11) Second quarter and most recent nine months ended July 31. *Sales include excise taxes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 12 months, not necessarily for end of most recent fiscal year. They include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful.

Data: Standard & Poor's Compustat

The Listing Glossary

A quick guide to what you need to know to navigate these tables

SALES: Includes all sales and other operating revenues. For banks, includes all operating revenues.

PROFITS: Net income before extraordinary items. For banks, profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available for common stockholders (most recent 12 months) to

latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on Nov. 4, 2004, common-stock price and corporate earnings from

continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

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IF IT’S A REALLY,
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There it is. Over there. That great opportunity. You try to get everyone in your place to go after it. That's when you realize what three years of belt-tightening have done. The "lean times" business model doesn't quite match the new "time to grow again" agenda. How do you get more responsive? More flexible? **"THROUGH YOGA?"**

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS				RET. RN O COM. EQ 12 MONTHS ENDING 9-30	FIN. INGS RATIO AS OF 11-4	EARN PER SHARE
	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %					
Centex CTX ⁽⁹⁾	2984.9**	23	8943.6	22	210.6	12	655.8	26	7.1	7.7	23.9	8	6.56		
Fortune Brands FO	1741.5	16	5195.2	20	226.8	55	534.3	27	13.0	9.7	24.8	17	4.60		
Furniture Brands International FBN	557.8	0	1792.0	2	19.4	0	69.2	-4	3.5	3.5	9.6	14	1.64		
Harman International Industries HAR ⁽⁶⁾	691.7	16	2114.2	19	33.7	70	130.3	48	4.9	3.3	18.5	51	2.47		
Hovnanian Enterprises HOV ⁽²⁾	1063.7**	25	2757.7	28	86.7	26	214.9	29	8.2	8.1	29.1	8	4.70		
KB Home KBH ⁽¹⁾	1748.3	21	4672.1	17	117.9	20	294.2	27	6.7	6.8	23.7	8	10.29		
La-Z-Boy LVB ⁽⁸⁾	466.4	3	1502.8	0	-3.5	NM	-22.0	NM	NM	1.3	-1.3	NM	-0.14		
Leggett & Platt LEG	1338.0	16	3803.3	17	80.2	58	219.8	50	6.0	4.4	12.5	20	1.42		
Lennar LEN ⁽¹⁾	2748.4	21	6954.2	16	225.2	12	565.9	21	8.2	8.9	23.0	9	5.11		
M.D.C. Holdings MDC	1026.0	28	2664.6	30	105.1	60	248.5	71	10.2	8.2	25.0	8	9.27		
Maytag MYG	1186.0	-3	3557.2	1	7.1	-80	4.8	-95	0.6	2.9	59.4	60	0.30		
Meritage Homes MTH	482.7**	27	1340.2	34	35.6	38	87.2	39	7.4	6.8	25.4	11	8.54		
Mohawk Industries MHK	1531.2	17	4409.3	21	112.7	23	266.2	28	7.4	7.0	14.4	16	5.45		
Newell Rubbermaid NWL	1671.8	-3	4939.9	-3	-235.0	NM	-143.3	NM	NM	4.9	-21.8	NM	-1.29		
NVR NVR	1168.6**	19	3050.4	19	147.7	35	364.3	25	12.6	11.2	75.9	10	61.27		
Pulte Homes PHM	2967.1	24	7524.8	27	259.2	61	578.7	57	8.7	6.7	20.2	9	6.41		
Ryland Group RYL	1034.3	19	2707.4	14	83.0	31	211.9	36	8.0	7.3	31.1	8	11.69		
Snap-on SNA	568.8	8	1797.2	10	22.8	29	57.7	-6	4.0	3.4	7.5	23	1.29		
Standard Pacific SPF	869.8	39	2178.2	41	74.6	29	177.0	42	8.6	9.2	21.7	8	7.42		
Stanley Works SWK	791.2	19	2364.5	21	63.9	71	183.8	180	8.1	5.6	19.6	19	2.57		
Technical Olympic USA TOUS	517.3	17	1462.0	22	28.1	31	70.2	13	5.4	4.9	14.8	13	2.00		
Toll Brothers TOL ⁽²⁾	1007.6**	45	2423.6	30	106.0	56	228.5	37	10.5	9.8	18.6	12	4.01		
WCI Communities WCI	472.2	43	1069.6	22	28.7	68	61.3	33	6.1	5.2	14.5	9	2.65		
Whirlpool WHR	3318.0	7	9588.0	9	101.0	-4	309.0	7	3.0	3.4	31.3	10	6.22		
William Lyon Homes WLS†	475.0	122	1114.0	150	44.9	202	91.5	173	9.5	6.9	43.0	5	13.11		
(B) LEISURE EQUIPMENT & PRODUCTS															
INDUSTRY COMPOSITE	8458.2	6	22034.9	10	542.3	-5	1006.4	16	6.4	7.2	13.2	22	1.20		
Brunswick BC	1273.2	23	3895.5	28	72.9	92	211.0	121	5.7	3.7	15.0	18	2.61		
Eastman Kodak EK	3364.0	1	9752.0	5	45.0	-61	204.0	-2	1.3	3.4	5.6	42	0.75		
Hasbro HAS	947.3	-2	1938.0	-4	88.7	3	114.1	16	9.4	8.8	12.7	19	0.97		
K2 KTO	333.5	99	861.8	64	13.2	293	30.1	225	4.0	2.0	4.8	22	0.76		
Mattel MAT	1667.5	-2	3252.4	1	255.9	-5	288.4	-11	15.3	15.8	22.3	15	1.17		
Polaris Industries PII	510.6	15	1234.2	13	44.6	6	89.1	11	8.7	9.5	38.6	23	2.82		
SCP Pool POOL	362.1	7	1100.9	14	22.0	20	69.7	29	6.1	5.4	27.6	26	1.18		
(C) TEXTILES, APPAREL & LUXURY GOODS															
INDUSTRY COMPOSITE	13416.4	15	35537.1	13	1134.3	24	2562.9	22	8.5	7.9	17.3	19	2.68		
Brown Shoe BWS ⁽¹⁾	458.7	0	1384.3	2	7.8	-32	21.5	-28	1.7	2.5	11.5	13	2.26		
Coach COH ⁽⁶⁾	344.1	33	995.3	40	67.7	60	191.7	84	19.7	16.4	36.3	32	1.49		
Columbia Sportswear COLM	417.4	12	796.6	15	68.6	8	99.3	13	16.4	17.0	18.2	19	3.21		
Jones Apparel Group JNY	1296.1	10	3566.8	5	95.8	2	267.7	-7	7.4	8.0	11.7	15	2.44		
Kellwood KWD ⁽¹⁾	560.5	10	1767.7	4	10.2	30	48.1	29	1.8	1.5	11.4	11	2.85		
Liz Claiborne LIZ	1306.6	11	3435.3	7	111.6	14	230.9	12	8.5	8.3	17.4	15	2.76		
Nike NKE ⁽⁷⁾	3561.8	18	9952.9	18	326.8	25	832.1	32	9.2	8.6	20.1	23	3.74		
Phillips-Van Heusen PVH ⁽¹⁾	375.9	-1	1111.3	3	13.0	45	5.4	-57	3.5	2.4	0.5	NM	0.00		
Polo Ralph Lauren RL ⁽⁹⁾	883.7	25	2295.2	22	80.4	49	170.3	29	9.1	7.6	13.4	20	2.01		
Quiksilver ZQK ⁽²⁾	337.9	34	916.7	30	19.5	64	56.5	37	5.8	4.7	13.4	22	1.25		
Reebok International RBK	1164.7	12	2810.2	6	81.8	31	144.7	12	7.0	6.0	15.1	14	2.78		
Russell RML	422.7	9	964.2	9	26.9	46	37.6	32	6.4	4.8	9.4	11	1.59		
Timberland TBL	493.9	11	1045.9	13	68.6	29	107.7	37	13.9	12.0	29.4	16	4.10		
VF VFC	1792.6**	25	4494.8	18	155.4	24	349.4	20	8.7	8.7	19.2	14	4.07		
3 HOTELS, RESTAURANTS & LEISURE															
INDUSTRY GROUP COMPOSITE	26619.8	13	75115.3	15	3155.8	32	7172.1	41	11.9	10.2	13.5	23	1.66		
Boyd Gaming BYD	522.5	68	1194.4	26	35.5	361	64.5	126	6.8	2.5	15.7	34	1.06		
Brinker International EAT ⁽⁶⁾	910.5	5	2860.6	11	14.7	-67	80.0	-39	1.6	5.1	14.0	26	1.29		
Caesars Entertainment CZR	1119.0	4	3305.0	6	49.0	9	164.0	39	4.4	4.2	2.6	74	0.25		
Carnival CCL ⁽¹⁾	3245.0	29	7485.0	53	1025.0	40	1561.0	58	31.6	29.1	11.5	24	2.16		
CBRL Group CBRL ⁽⁵⁾	607.5	5	1804.6	8	29.9	-16	85.1	2	4.9	6.1	12.9	17	2.25		
CKE Restaurants CKR ⁽¹⁾	353.7	6	1134.4	8	-11.1	NM	-49.6	NM	NM	1.9	-32.4	NM	-0.81		
Darden Restaurants DRI ⁽⁷⁾	1278.6	2	3879.8	6	72.1	5	203.7	6	5.6	5.4	18.5	19	1.40		
Harrah's Entertainment HET	1309.7	26	3359.3	12	110.7	24	269.7	16	8.5	8.5	17.0	22	2.71		
Hilton Hotels HLT	1053.0	9	3132.0	9	61.0	79	173.0	78	5.8	3.5	10.0	34	0.62		
International Game Technology IGT ⁽³⁾	621.7	14	1876.7	15	54.3	-47	313.1	8	8.7	18.6	21.7	30	1.18		
Mandalay Resort Group MBG† ⁽¹⁾	713.8	11	2047.3	13	58.2	38	168.4	86	8.2	6.6	17.7	22	3.14		
Marriott International MAR	2304.0	9	6958.0	13	132.0	42	406.0	33	5.7	4.4	15.3	24	2.38		
McDonald's MCD	4925.7	9	14054.4	12	778.4	42	1880.6	36	15.8	12.2	15.8	19	1.58		
MGM Mirage MGG	1036.4	5	3175.4	9	76.2	84	275.0	90	7.3	4.2	13.8	23	2.50		
Outback Steakhouse OSI	803.5	17	2448.0	21	28.3	-25	120.7	-3	3.5	5.5	15.4	19	2.13		
Royal Caribbean Cruises RCL	1386.1	24	3590.8	24	282.5	47	500.5	66	20.4	17.1	10.1	21	2.28		

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO 11-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Starwood Hotels & Resorts Worldwide HOT	1336.0	18	3926.0	14	105.0	123	258.0	NM	7.9	4.1	7.4	31	1.63
Wendy's International WEN	914.0	13	2657.7	16	69.1	4	193.5	13	7.6	8.2	13.7	16	2.23
YUM! Brands YUM	2179.0	10	6226.0	9	185.0	13	505.0	25	8.5	8.2	47.5	19	2.36
4 MEDIA													
INDUSTRY GROUP COMPOSITE	47193.1	8	139773.1	9	-920.9	NM	4532.8	-32	NM	5.6	2.9	59	0.48
Belo BLC	374.7	5	1117.1	7	11.2	-64	79.0	-8	3.0	8.7	7.7	24	1.03
Charter Communications CHTR	1248.0	3	3701.0	3	-2529.0	NM	-3237.0	NM	NM	3.1	NM	NM	-11.02
Clear Channel Communications CCU	2648.9	4	7103.5	7	261.2	-59	631.5	-34	9.9	25.0	5.6	25	1.34
Comcast CMCSA	5098.0	12	15072.0	11	220.0	NM	547.0	NM	4.3	NM	2.3	72	0.41
Cox Communications COX	1618.1	11	4753.7	12	42.0	NM	162.3	NM	2.6	NM	1.5	NM	0.23
DIRECTV Group DTV	2861.9	20	7997.9	21	-925.6	NM	-768.0	NM	NM	NM	-13.9	NM	-0.78
Dow Jones DJ	394.9	5	1234.3	9	12.1	-58	63.9	-49	3.1	7.6	88.8	34	1.32
Fox Entertainment Group FOX (6)	2889.0	5	8926.0	8	320.0	-20	942.0	1	11.1	14.5	7.1	23	1.32
Gannett GCI	1815.9**	11	5418.9	11	310.2	11	939.0	10	17.1	17.1	15.2	18	4.78
Interpublic Group IPG	1508.8	6	4448.0	5	-584.9	NM	-607.2	NM	NM	NM	-33.1	NM	-1.76
Knight-Ridder KRI	722.2	2	2194.7	2	76.9	11	219.1	11	10.6	9.8	21.8	18	3.98
McGraw-Hill MHP	1695.9	6	3837.8	6	324.5	12	566.4	20	19.1	18.1	27.3	22	4.06
Metro-Goldwyn-Mayer MGM	401.3	-12	1271.4	-5	-26.7	NM	-67.7	NM	NM	NM	-2.8	NM	-0.04
New York Times NYT	773.8	2	2399.7	2	48.3	-4	182.4	-5	6.2	6.6	21.3	21	1.94
nti NTLI	1060.8	19	3192.4	20	-173.5	NM	-742.3	NM	NM	NM	-32.1	NM	-11.53
Omnicom Group OMC	2319.0	14	6958.1	14	145.3	17	487.0	16	6.3	6.1	19.4	21	3.77
Reader's Digest Association RDA (6)	490.0	-1	1587.4	-2	-30.3	NM	-33.8	NM	NM	NM	7.2	45	0.32
Regal Entertainment Group RGC	611.3	-3	1824.9	1	27.8	-37	58.0	-54	4.5	7.0	148.0	26	0.79
Scripps (E.W.) SSP†	499.8	13	1560.8	15	55.6	7	212.5	26	11.1	11.8	15.6	25	1.91
Time Warner TWX	9965.0	5	30979.0	8	494.0	-10	2088.0	2	5.0	5.8	5.4	25	0.68
Tribune TRB	1413.9	2	4242.1	3	121.7	-33	338.7	-39	8.6	13.2	10.1	22	2.01
Univision Communications UVN	477.4	49	1325.6	47	73.4	74	188.7	95	15.4	13.1	4.7	46	0.71
Viacom VIA.B	5484.6	4	16229.5	9	722.6	12	2056.4	25	13.2	12.3	2.8	39	0.96
Washington Post WPO	820.0	16	2397.4	17	82.5	314	226.8	48	10.1	2.8	13.8	28	32.69
5 RETAILING													
INDUSTRY GROUP COMPOSITE	160309.4	8	491326.5	9	4737.8	-5	19775.9	34	3.0	3.4	14.5	24	1.58
(A) DISTRIBUTORS													
INDUSTRY COMPOSITE	3323.8	10	9597.3	9	116.4	20	346.5	21	3.5	3.2	16.4	19	2.03
Genuine Parts GPC	2349.3	7	6844.0	8	97.9	11	299.2	12	4.2	4.0	15.6	19	2.21
WESCO International WCC	974.5	18	2753.3	13	18.5	120	47.3	130	1.9	1.0	24.9	20	1.30
(B) INTERNET & CATALOG RETAIL													
INDUSTRY COMPOSITE	4571.9	14	13492.9	17	347.9	121	1091.0	303	7.6	3.9	7.1	72	0.77
Amazon.com AMZN	1462.5	29	4380.2	32	54.1	248	241.8	NM	3.7	1.4	NM	50	0.74
eBay EBAY	805.9	52	2335.5	54	182.3	68	572.8	88	22.6	20.5	11.7	95	1.06
IAC/InterActiveCorp IACI	1505.1	-7	4477.0	-1	91.5	310	226.9	NM	6.1	1.4	2.5	52	0.48
Insight Enterprises NSIT	798.5	9	2300.2	6	19.9	88	49.5	92	2.5	1.5	12.0	15	1.26
(C) MULTILINE RETAIL													
INDUSTRY COMPOSITE	48973.3	0	161777.0	0	1088.5	50	5620.3	118	2.2	1.5	17.1	16	2.41
Big Lots BLI (11)	995.0	5	3342.8	7	-7.3	NM	93.2	36	NM	NM	8.4	16	0.75
Dillard's DDS (11)	1730.1**	-3	6013.5	-3	-26.0	NM	78.9	71	NM	NM	2.8	29	0.75
Dollar General DG (11)	1836.2	11	5550.7	11	71.3	19	242.0	6	3.9	3.6	20.8	22	0.95
Dollar Tree Stores DLTR (11)	704.2	12	2307.6	14	29.6	3	144.6	13	4.2	4.6	17.1	19	1.57
Family Dollar Stores FDO (4)	1324.2	10	4037.2	11	43.0	-10	198.2	4	3.2	3.9	19.3	20	1.53
Federated Department Stores FD (11)	3548.0**	3	12118.0	3	78.0	-35	635.0	25	2.2	3.5	12.0	14	3.82
Fred's FRED (11)	340.9	13	1060.4	13	3.1	-29	23.0	-1	0.9	1.5	10.6	22	0.81
Kmart Holding KMRT (11)	4785.0	-15	15728.0	-23	155.0	NM	524.0	NM	3.2	NM	19.7	18	4.99
Kohl's KSS (11)	2497.9	13	8440.0	12	155.8	39	516.4	3	6.2	5.1	14.2	28	1.85
May Department Stores MAY (11)	2956.0**	-1	10413.0	2	101.0	NM	602.0	72	3.4	NM	14.9	13	2.10
Neiman Marcus Group NMG.A (5)	789.0	12	2720.7	15	20.6	187	148.6	84	2.6	1.0	14.9	16	4.19
Nordstrom JWN (11)	1996.5**	10	5544.8	11	106.9	62	280.0	83	5.4	3.6	17.4	20	2.30
Penney (J.C.) JCP (11)	3857.0	6	13988.0	7	72.0	NM	443.0	132	1.9	NM	9.6	21	1.76
Retail Ventures RVI (11)	633.2	5	2002.9	7	1.2	NM	11.1	NM	0.2	NM	5.5	23	0.27
Saks SKS (11)	1350.4	9	4859.5	9	-28.9	NM	74.9	32	NM	NM	4.3	20	0.61
Sears, Roebuck S	8295.0	-15	24870.0	-14	-61.0	NM	-28.0	NM	NM	1.5	50.2	3	10.71
ShopKo Stores SKO (11)	778.8	1	2472.9	1	8.3	8	37.5	-5	1.1	1.0	6.4	14	1.30
Target TGT (11)	10556.0**	10	36307.0	11	366.0	11	1596.0	19	3.5	3.4	15.3	27	1.91
(D) SPECIALTY RETAIL													
INDUSTRY COMPOSITE	103440.3	11	306459.5	13	3185.0	-21	12718.0	10	3.1	4.3	14.5	24	1.42
Abercrombie & Fitch ANF (11)	401.3	13	1373.7	11	42.9	23	166.8	9	10.7	9.8	23.2	19	2.22
Advance Auto Parts AAP	890.2	6	2921.5	9	51.4	15	156.0	70	5.8	5.3	24.8	16	2.49
American Eagle Outfitters AEOS (11)	413.8	23	1281.1	14	29.6	266	90.1	69	7.2	2.4	13.6	30	1.37
AnnTaylor Stores ANN (11)	472.6	21	1354.6	24	30.2	43	93.5	69	6.4	5.4	12.6	14	1.69

FOUR WHEELS. FOUR POWER OUTLETS.



PUTTING HYBRID TRUCKS TO WORK WHEN DISASTER STRIKES.

If there were ever any doubts that hybrid vehicles could deliver the same power as their traditional counterparts, they were quickly erased this summer.

As a fleet of hybrid trucks rolled into Florida in the wake of this season's hurricanes, everyone knew they'd help get people and supplies where they needed to go. But in times like these, it seems the real benefit of a hybrid engine is mobile electricity. And with accessory power outlets standard on every GM hybrid, these trucks — capable of running power tools or doubling as generators — actually pack more power than their predecessors.

When power lines are down, it's these outlets — two in the cab and two in the cargo box — that really make an impact. Whether it's running the power tools that help to restore homes, plugging in much-needed medical equipment or just providing some lamplight, electricity plays a critical role in the rebuilding process.

Real world problems. Real world solutions. We're glad our hybrid trucks — the Chevy Silverado and GMC Sierra* — have been able to provide assistance in Florida. But that's just the beginning. In 2006, we plan to introduce a hybrid version of our Saturn VUE. After that, we plan to offer these engines in the GMC Yukon, Chevy Tahoe and Chevy Malibu.

So while they're saving energy, hybrids are also producing it in ways we've never seen before. Which means the question isn't, are they powerful enough? It's more like, how much power do you need?



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CHEVROLET PONTIAC BUICK CADILLAC GMC OLDSMOBILE SATURN HUMMER SAAB

*Offers only in CA, OR, WA, AK, NV and FL. Quantities are limited. Two-wheel drive 2004 EPA estimated fuel economy 18 city/20 highway.

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS				REVENUE PER SHARE	EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %	9 MONTHS 2004 %	9 MONTHS 2003 %		
Asbury Automotive Group ABG	1390.0	12	3948.1	13	13.0	-22	38.7	1	0.9	1.3	4.1	24	0.57	
AutoNation AN	5097.4	-1	14752.7	2	95.0	-13	278.9	-35	1.9	2.1	8.7	14	1.30	
AutoZone AZO (4)	1835.7	0	4355.0	3	209.4	1	444.5	8	11.4	11.3	330.4	13	6.56	
Barnes & Noble BKS (11)	1445.9	13	5088.0	18	8.9	-35	150.4	23	0.6	1.1	12.2	17	2.07	
Bed Bath & Beyond BBBY (10)	1274.0	15	3672.8	20	120.0	23	346.3	33	9.4	8.7	20.2	28	1.46	
Best Buy BBY (10)	6080.0	13	20004.0	17	150.0	7	733.0	25	2.5	2.6	23.7	24	2.59	
Blockbuster BBI	1410.0	2	4334.3	1	-1416.4	NM	-1257.0	NM	NM	4.6	-71.8	NM	-13.51	
Boise Cascade BCC	3650.9	73	10581.8	80	61.1	86	175.0	NM	1.7	1.6	7.5	17	1.86	
Borders Group BGP (11)	853.4	2	3012.4	7	8.5	89	133.4	26	1.0	0.5	12.3	14	1.69	
Building Materials Holding BMHC	591.5	49	1551.7	56	18.1	129	34.9	146	3.1	2.0	13.3	10	2.96	
Burlington Coat Factory BCF (7)	576.9	10	2111.2	10	-18.7	NM	40.9	63	NM	NM	8.2	15	1.54	
Cabela's CAB	383.8	16	976.9	16	16.5	61	26.5	62	4.3	3.1	11.7	25	1.03	
CarMax KMX (10)	1323.5	7	3765.4	12	29.9	-25	87.7	-7	2.3	3.2	14.2	26	1.01	
Charming Shoppes CHRS (11)	611.7	1	1790.1	1	27.7	49	64.8	101	4.5	3.1	9.7	16	0.54	
Circuit City Stores CC (10)	2345.0	8	7676.5	5	-11.4	NM	78.0	NM	NM	NM	2.4	71	0.24	
CSK Auto CAO (11)	409.1	-2	1178.5	3	13.9	28	4.2	-81	3.4	2.6	5.7	36	0.41	
Dick's Sporting Goods DKS (11)	416.1	18	1254.8	19	17.9	16	54.8	33	4.3	4.4	22.7	32	1.14	
Electronics Boutique Holdings ELBO (11)	362.0	20	1405.9	23	3.9	133	46.3	27	1.1	0.6	17.1	18	1.91	
Foot Locker FL (11)	1268.0	13	3788.0	9	45.0	22	163.0	31	3.5	3.3	13.6	16	1.48	
GameStop GME (11)	345.6	13	1342.7	17	7.7	16	53.9	20	2.2	2.2	10.8	19	1.09	
Gap GPS (11)	3721.0	1	12275.0	5	194.0	-7	862.0	31	5.2	5.7	21.0	19	1.18	
Group 1 Automotive GPI	1532.4	24	3994.3	17	-9.6	NM	16.6	-71	NM	1.8	6.6	19	1.55	
Guitar Center GTRC	354.9	18	1044.2	19	12.4	115	36.3	111	3.5	1.9	20.1	21	2.16	
Hollywood Entertainment HLYW	410.6	2	1276.5	6	16.0	-22	58.9	-1	3.9	5.1	21.1	8	1.30	
Home Depot HD (11)	19960.0	11	52635.0	14	1545.0	19	3594.0	24	7.7	7.2	21.1	20	2.10	
Jo-Ann Stores JAS (11)	371.0	3	1328.5	5	0.5	NM	34.3	26	0.1	NM	12.6	12	2.01	
Limited Brands LTD (11)	2210.8	10	7419.9	9	148.0	45	632.4	14	6.7	5.1	17.3	17	1.48	
Linens 'n Things LIN	654.2	9	1785.7	11	17.2	-18	18.1	-37	2.6	3.5	8.1	17	1.42	
Lithia Motors LAD	755.9	8	2076.0	9	14.3	12	32.7	27	1.9	1.8	10.8	11	2.23	
Lowe's LOW (11)	10169.0	17	26102.0	20	704.0	19	1560.0	17	6.9	6.9	19.0	24	2.50	
Men's Wearhouse MW (11)	369.5	11	1152.9	11	18.2	59	51.8	22	4.9	3.4	11.8	20	1.63	
Michaels Stores MIK (11)	682.9	11	2471.9	10	26.7	10	150.6	25	3.9	3.9	16.0	22	1.35	
Office Depot ODP	3327.8	3	10095.3	11	89.9	-2	285.4	12	2.7	2.8	10.8	16	1.05	
O'Reilly Automotive ORLY	455.2	10	1293.6	13	33.2	13	93.0	22	7.3	7.2	13.1	21	2.11	
Payless ShoeSource PSS (11)	727.9	0	2094.3	1	3.7	-29	0.3	-99	0.5	0.7	-0.3	NM	-0.02	
Pep Boys-Manny, Moe & Jack PBYY (11)	593.4	7	1689.2	10	14.6	NM	26.9	NM	2.5	NM	5.3	22	0.67	
Petco Animal Supplies PETC (11)	438.5	13	1320.0	13	19.3	43	56.0	27	4.4	3.5	84.6	28	1.29	
Petsmart PETM (11)	806.0	11	2442.0	13	34.1	21	127.2	65	4.2	3.9	17.3	32	1.06	
Pier 1 Imports PIR (10)	452.3**	6	1439.6	7	10.4	-43	70.5	-23	2.3	4.3	15.8	16	1.13	
RadioShack RSH	1101.5	4	3247.9	3	69.7	22	206.3	21	6.3	5.4	39.1	16	2.03	
Regis RGS (6)	506.2	10	1496.2	12	25.5	2	78.3	15	5.0	5.4	14.8	19	2.29	
Rent-A-Center RCII	569.6	4	1728.0	4	5.6	-87	109.0	-16	1.0	8.0	20.6	12	1.96	
Ross Stores ROST (11)	1008.6	4	3099.2	10	32.6	-40	154.8	-5	3.2	5.7	28.4	21	1.34	
Sherwin-Williams SHW	1677.1	12	4614.6	12	132.9	10	310.8	19	7.9	8.0	25.4	17	2.62	
Sonic Automotive SAH	1983.0	5	5553.0	5	22.3	16	76.1	14	1.1	1.0	12.6	10	2.11	
Sports Authority TSA (11)	605.0	126	1889.0	132	6.7	28	25.4	14	1.1	2.0	3.8	41	0.65	
Staples SPLS (11)	3089.3	9	10222.6	10	122.5	39	460.1	66	4.0	3.1	16.9	25	1.24	
Talbots TLB (11)	409.4**	5	1259.9	4	19.4	5	74.7	-2	4.7	4.8	17.6	15	1.90	
TBC TBCC	476.5	31	1366.8	44	10.9	9	25.6	13	2.3	2.8	11.9	16	1.51	
Tiffany TIF (11)	476.6**	8	1665.1	14	36.6	-11	187.4	13	7.7	9.3	14.3	21	1.45	
TJX TJX (11)	3414.3	12	10872.6	16	118.2	-4	525.1	34	3.5	4.0	46.2	18	1.40	
Toys 'R' Us TOY (11)	2022.0	-4	9017.0	-1	61.0	NM	177.0	-27	3.0	NM	3.3	30	0.64	
Tractor Supply TSCO	426.4	18	1282.9	18	8.0	-34	43.1	4	1.9	3.4	17.0	25	1.44	
United Auto Group UAG	2688.0	16	7464.8	17	32.5	28	85.7	30	1.2	1.1	10.3	12	2.37	
Williams-Sonoma WSM (11)	689.6	19	2334.8	18	27.6	55	151.1	36	4.0	3.1	20.3	28	1.46	
Zale ZLC (5)	455.6	3	1887.8	5	6.9	135	115.7	NM	1.5	0.7	14.7	15	1.99	

CONSUMER STAPLES

SECTOR COMPOSITE	302779.4	9	893324.2	10	17954.1	39	50632.1	18	5.9	4.7	23.0	21	2.05
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6 FOOD & STAPLES RETAILING

INDUSTRY GROUP COMPOSITE	173584.5	10	511689.4	10	4378.5	8	12583.1	3	2.5	2.6	16.3	26	1.52
Albertson's ABS (11)	10194.0	14	27481.0	2	125.0	-23	311.0	-42	1.2	1.8	7.6	22	1.09
BJ's Wholesale Club BJ (11)	1878.3	13	5455.1	12	28.1	27	93.7	12	1.5	1.3	12.9	18	1.62
Casey's General Stores CASY (8)	734.2*	20	1882.0	13	15.9	14	22.6	-18	2.2	2.3	8.5	24	0.78
Costco Wholesale COST (4)	15139.3**	11	37585.5	13	296.8	24	722.2	26	2.0	1.7	11.6	27	1.85
CVS	7909.4	24	21671.1	13	184.6	-2	663.7	14	2.3	2.9	13.7	21	2.23
Great Atlantic & Pacific Tea G&P (10)	2490.6	1	8470.5	5	-64.5	NM	-167.3	NM	NM	NM	-80.4	NM	-6.23

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO AS OF 11-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Kroger KR ⁽¹¹⁾	12980.0	5	42918.0	4	142.0	-25	68.0	-93	1.1	1.5	4.2	66	0.24
Longs Drug Stores LDG ⁽¹⁴⁾	1150.5	4	3536.8	5	3.4	-36	26.1	49	0.3	0.5	4.4	30	0.84
Nash Finch NAFC	1191.2**	-2	2977.0	1	14.6	26	3.7	-83	1.2	1.0	6.2	24	1.31
Pathmark Stores PTMK ⁽¹¹⁾	1011.7	2	3014.3	0	-1.6	NM	6.2	-59	NM	0.6	1.6	22	0.20
Performance Food Group PFGC	1547.8	11	4568.6	14	17.8	-18	44.0	-29	1.1	1.6	6.5	21	1.19
Publix Super Markets PUSH	4600.0	15	13800.0	11	183.7	36	586.5	36	4.0	3.4	22.4	9	4.28
Rite Aid RAD ⁽¹⁰⁾	4123.9	2	12764.6	4	9.8	NM	132.3	NM	0.2	NM	NM	11	0.32
Ruddick RDK ⁽³⁾	772.7	14	2176.2	6	17.9	9	50.9	8	2.3	2.4	11.8	16	1.38
Safeway SWY	8297.0	0	24296.9	-1	159.2	-21	357.5	-32	1.9	2.4	-8.4	NM	-0.77
7-Eleven SE	3260.9***	11	9164.9	12	45.8	29	104.7	27	1.4	1.2	24.0	25	0.90
Smart & Final SMF	603.2	12	1484.4	15	12.0	44	26.9	506	2.0	1.5	14.6	13	1.15
Spartan Stores SPTN ⁽⁹⁾	486.7	-1	1417.9	2	7.1	160	7.3	NM	1.5	0.6	2.8	32	0.15
Supervalu SVU ⁽¹⁰⁾	4487.0	-2	14269.7	4	78.5	26	222.8	22	1.8	1.4	15.7	15	2.09
Sysco SYS ⁽⁶⁾	7531.9	6	22696.5	11	225.9	8	702.3	13	3.0	2.9	33.5	25	1.42
United Natural Foods UNFI ⁽⁵⁾	446.4	22	1288.6	21	9.6	93	25.2	55	2.1	1.4	13.6	36	0.78
Walgreen WAG ⁽⁴⁾	9426.7	14	28787.4	15	327.2	18	1105.3	17	3.5	3.4	17.0	29	1.32
Wal-Mart Stores WMT ⁽¹¹⁾	70466.0**	11	211099.0	13	2651.0	16	7539.0	15	3.8	3.6	22.2	25	2.21
Weis Markets WMK	518.6	3	1560.7	3	12.2	12	42.1	4	2.4	2.2	9.6	18	2.07
Winn-Dixie Stores WIN ⁽⁶⁾	2336.6	-3	7322.6	-2	-123.6	NM	-113.8	NM	NM	0.2	-23.4	NM	-1.28
7 FOOD BEVERAGE & TOBACCO													
INDUSTRY GROUP COMPOSITE	100190.6	7	297629.4	10	9826.2	78	27928.6	25	9.8	5.9	23.4	18	2.29
(A) BEVERAGES													
INDUSTRY COMPOSITE	28123.6	3	80339.0	7	3642.4	3	10350.3	11	13.0	13.0	29.4	21	2.10
Anheuser-Busch BUD	4080.1	5	11567.1	6	684.4	3	1907.8	7	16.8	17.1	79.6	19	2.71
Brown-Forman BFB ⁽⁸⁾	496.0	8	1624.2	9	51.9	67	190.2	19	10.5	6.8	25.5	21	2.28
Coca-Cola KO	5662.0	0	16705.0	5	935.0	-24	3646.0	7	16.5	21.6	30.6	22	1.88
Coca-Cola Enterprises CCE	4670.0	-1	13754.0	6	207.0	-20	514.0	-6	4.4	5.5	12.7	16	1.37
Constellation Brands STZ ⁽¹⁰⁾	1036.9	14	2845.6	22	80.6	127	194.8	54	7.8	3.9	11.2	18	2.42
Coors (Adolph) RKY	1104.3	5	3178.5	7	64.1	4	141.0	2	5.8	5.9	12.4	15	4.72
Pepsi Bottling Group PBG	2934.0	4	7676.0	6	191.0	4	383.0	8	6.5	6.5	24.3	17	1.70
PepsiAmericas PAS	883.3	2	2530.6	5	64.3	3	146.5	21	7.3	7.2	11.7	17	1.29
PepsiCo PEP	7257.0	6	20458.0	8	1364.0	35	3227.0	22	18.8	14.8	32.3	22	2.38
(B) FOOD PRODUCTS													
INDUSTRY COMPOSITE	52882.7	10	161035.2	12	2952.5	9	8753.2	4	5.6	5.6	16.5	19	1.76
Archer Daniels Midland ADM ⁽⁶⁾	8972.4	13	27967.4	17	266.3	77	390.0	8	3.0	1.9	7.7	21	0.94
Bunge BG	6560.0	13	18956.0	20	182.0	100	364.0	16	2.8	1.6	15.1	12	4.21
Campbell Soup CPB ⁽⁵⁾	1433.0	-2	5200.0	5	59.0	-20	436.0	0	4.1	5.1	74.0	17	1.57
Chiquita Brands International CQB	661.6	5	2303.2	19	-19.8	NM	30.3	-65	NM	1.7	5.0	20	0.97
ConAgra Foods CAG ⁽⁷⁾	3495.6	8	10983.5	6	133.3	-20	522.3	-10	3.8	5.2	16.4	19	1.44
Corn Products International CPO	587.4	9	1709.8	10	24.0	20	79.2	53	4.1	3.7	10.2	18	2.80
Dean Foods DF	2772.5	20	8031.2	20	40.2	-67	186.5	-31	1.5	5.3	10.6	19	1.69
Del Monte Foods DLM ⁽⁸⁾	626.0	2	2353.0	23	8.6	-36	115.1	89	1.4	2.2	13.6	14	0.75
Fresh Del Monte Produce FDP	610.4	8	2087.8	9	13.7	-60	120.1	-41	2.2	6.1	13.5	11	2.48
General Mills GIS ⁽⁷⁾	2589.0	3	8081.0	5	183.0	-19	703.0	2	7.1	9.0	18.8	17	2.63
Heinz (H.J.) HNZ ⁽⁸⁾	2003.0	6	6431.6	4	194.8	4	595.5	42	9.7	9.9	41.5	17	2.22
Hershey Foods HSY	1254.5	5	3161.3	6	166.2	10	420.6	31	13.3	12.7	60.1	24	2.17
Hormel Foods HRL ⁽²⁾	1156.0	15	3434.7	13	56.3	62	161.8	40	4.9	3.4	17.0	18	1.65
Kellogg K	2445.3	7	7223.1	8	247.0	7	704.2	18	10.1	10.1	47.7	20	2.15
Kraft Foods KFT	7831.0	5	23729.0	5	779.0	-4	2037.0	-22	9.9	10.8	9.9	20	1.69
McCormick MKC ⁽¹⁾	613.5	10	1782.1	13	46.2	15	127.2	14	7.5	7.2	26.6	25	1.51
Ralcorp RAH ⁽³⁾	426.2	29	1195.9	25	12.5	NM	53.4	NM	2.9	NM	14.7	18	2.17
Sara Lee SLE ⁽⁶⁾	4861.0	4	14744.0	8	352.0	53	1082.0	36	7.2	4.9	46.1	13	1.74
Smithfield Foods SFD ⁽⁸⁾	2651.7	34	7877.4	42	54.9	212	168.1	581	2.1	0.9	12.4	14	1.79
Smucker (J.M.) SJM ⁽⁸⁾	415.8	22	1096.5	8	27.5	9	81.0	6	6.6	7.4	7.0	21	2.20
Wrigley (Wm.) Jr. WWY	916.7	17	2686.7	20	125.8	11	376.0	12	13.7	14.4	25.0	31	2.16
(C) TOBACCO													
INDUSTRY COMPOSITE	19184.3	7	56255.3	6	3231.3	NM	8825.1	95	16.8	NM	30.6	12	4.29
Altria Group MO	15977.0	4	47944.0	6	2648.0	6	7469.0	5	16.6	16.3	32.9	12	4.64
Carolina Group CG	879.3	4	2515.3	2	159.9	37	384.3	10	18.2	13.8	NM	10	2.96
Reynolds American RAI	1866.0	35	4436.0	10	290.0	NM	562.0	NM	15.5	NM	2.9	63	1.13
UST UST	462.0	6	1360.0	6	133.4	7	409.8	12	28.9	28.7	NM	20	2.18
8 HOUSEHOLD & PERSONAL PRODUCTS													
INDUSTRY GROUP COMPOSITE	29004.2	11	84005.3	14	3749.5	11	10120.4	19	12.9	12.9	39.4	22	2.30
(A) HOUSEHOLD PRODUCTS													
INDUSTRY COMPOSITE	22152.2	10	64377.0	14	2954.6	9	7879.7	17	13.3	13.5	37.7	20	2.61
Clorox CLX ⁽⁶⁾	1090.0**	4	3419.0	6	123.0	-5	428.0	7	11.3	12.4	32.8	22	2.51
Colgate-Palmolive CL	2695.7	7	7780.9	6	329.0	-10	1041.4	-1	12.2	14.5	142.9	19	2.48
Energizer Holdings ENR ⁽³⁾	756.2	7	2001.0	21	60.3	83	152.4	83	8.0	4.7	34.5	14	3.21

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO AS OF 11-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Kimberly-Clark KMB	3866.3	6	11441.1	7	441.3	5	1354.9	10	11.4	11.5	27.5	17	3.61
Procter & Gamble PG (6)	13744.0	13	39735.0	18	2001.0	14	4903.0	23	14.6	14.4	36.4	22	2.43
(B) PERSONAL PRODUCTS													
INDUSTRY COMPOSITE	6852.0	12	19628.3	13	794.9	18	2240.7	27	11.6	11.0	47.1	26	1.64
Alberto-Culver ACV (2)	850.7	13	2493.2	14	48.0	5	140.0	11	5.6	6.1	10.8	30	1.54
Avon Products AVP	1806.2	11	5437.3	15	176.9	33	557.3	38	9.8	8.2	115.5	23	1.72
Estee Lauder EL (6)	1504.1	12	4328.8	14	95.0	22	266.4	22	6.3	5.8	22.6	26	1.69
Gillette G	2691.0	12	7369.0	11	475.0	14	1277.0	26	17.7	17.3	63.4	27	1.61
ENERGY													
SECTOR COMPOSITE	221786.3	30	619085.5	22	16784.6	58	49006.2	41	7.6	6.2	20.0	13	3.75
9 ENERGY													
INDUSTRY GROUP COMPOSITE	221786.3	30	619085.5	22	16784.6	58	49006.2	41	7.6	6.2	20.0	13	3.75
(A) ENERGY EQUIPMENT & SERVICES													
INDUSTRY COMPOSITE	15425.4	17	45656.7	24	1150.6	401	2432.1	120	7.5	1.7	10.0	37	1.20
Baker Hughes BHI	1538.1	16	4424.7	16	137.3	NM	348.4	385	8.9	NM	12.4	31	1.36
BJ Services BJS (3)	694.5	18	2000.2	20	85.6	42	288.2	86	12.3	10.3	17.8	22	2.14
Cooper Cameron CAM	538.5**	25	1545.6	30	29.5	23	65.4	23	5.5	5.6	6.0	39	1.28
FMC Technologies FTI	700.0	25	1934.2	16	22.0	18	59.5	25	3.1	3.3	15.2	25	1.21
Halliburton HAL	4790.0**	15	15265.0	41	186.0	102	204.0	6	3.9	2.2	20.8	46	0.80
Maverick Tube MVK	400.7	77	1060.1	65	68.5	690	156.9	NM	17.1	3.8	30.9	7	3.99
Nabors Industries NBR	585.7	24	1709.3	26	75.6	50	193.7	52	12.9	10.6	9.3	29	1.66
National-Oilwell NOI	618.9	24	1648.7	12	27.8	28	60.2	5	4.5	4.4	6.4	36	0.93
Pride International PDE	442.8	-2	1322.7	5	-18.2	NM	-22.4	NM	NM	6.4	-3.6	NM	-0.45
Schlumberger SLB	2931.1	15	8482.3	13	297.1	NM	655.6	219	10.1	NM	15.0	42	1.50
Smith International SII	1119.2	21	3201.4	23	51.9	48	124.2	43	4.6	3.8	12.0	36	1.59
Transocean RIG	651.8	5	1937.0	5	154.9	NM	225.6	NM	23.8	1.8	3.1	49	0.72
Varco International VRC	414.3	11	1125.5	3	32.5	20	72.9	5	7.8	7.3	7.2	35	0.79
(B) OIL & GAS													
INDUSTRY COMPOSITE	206360.9	31	573428.7	22	15634.0	51	46574.0	39	7.6	6.6	21.1	12	4.23
Amerada Hess AHC	3830.0	19	12120.0	13	178.0	22	741.0	86	4.6	4.5	13.8	10	7.98
Anadarko Petroleum APC	1562.0	17	4465.0	16	401.0	45	1200.0	26	25.7	20.6	16.4	11	5.89
Apache APA	1414.1	27	3814.3	22	433.7	57	1156.0	39	30.7	25.0	19.7	12	4.30
Ashland ASH (3)	2348.0	10	6413.0	10	203.0	233	359.0	278	8.6	2.8	14.7	10	5.59
Burlington Resources BR	1411.0	33	4052.0	25	389.0	46	1122.0	29	27.6	25.2	25.3	11	3.81
Chesapeake Energy CHK	629.8	39	1767.2	40	96.9	10	306.6	27	15.4	19.3	21.5	14	1.23
ChevronTexaco CVX	37558.0	33	103385.0	23	2936.0	50	9575.0	70	7.8	6.9	26.3	10	5.32
ConocoPhillips COP	30258.0**	34	83579.0	22	2011.0	61	5627.0	56	6.6	5.5	16.6	9	9.54
Devon Energy DVN	2267.0**	16	6724.0	24	517.0	25	1513.0	27	22.8	21.2	16.2	9	8.32
EOG Resources EOG	594.3	30	1576.0	17	172.3	47	418.1	15	29.0	25.7	18.7	17	4.06
Exxon Mobil XOM	69330.0	29	194695.0	19	5680.0	56	16910.0	18	8.2	6.8	25.2	14	3.60
Frontier Oil FTO	791.6	33	2069.8	27	23.8	523	69.5	NM	3.0	0.6	34.0	9	2.70
Kerr-McGee KMG	1366.2	36	3579.6	13	7.4	-75	270.2	33	0.5	2.9	6.5	22	2.71
Marathon Oil MRO	11112.0	21	32088.0	20	222.0	-24	828.0	2	2.0	3.2	13.6	12	3.11
Murphy Oil MUR	2290.8**	83	6034.6	62	115.8	68	364.6	64	5.1	5.5	18.0	18	4.53
Newfield Exploration NFX	327.7	32	915.8	19	81.6	40	226.9	33	24.9	23.5	14.3	13	4.62
Occidental Petroleum OXY	3033.0	31	8363.0	20	758.0	70	1826.0	51	25.0	19.2	22.6	10	5.54
Pioneer Natural Resources PXD	452.8	35	1346.4	39	80.9	-58	210.8	-38	17.9	57.0	10.2	15	2.23
Pogo Producing PPP	364.2	30	999.0	12	86.6	28	223.4	-7	23.8	24.2	16.5	11	4.33
Premcor PCO	4407.7	81	10533.1	61	144.1	150	329.1	146	3.3	2.4	16.1	11	3.74
Sunoco SUN	5964.0	46	16392.0	37	104.0	-5	427.0	55	1.7	2.7	26.6	12	6.10
Tesoro Petroleum TSO	3288.5*	41	8873.4	32	64.6	-8	328.1	291	2.0	3.0	24.4	6	4.67
Unocal UCL†	1961.0	33	5712.0	19	329.0	119	877.0	66	16.8	10.2	21.7	11	3.93
Valero Energy VLO	14339.3	45	39228.4	38	434.5	127	1315.3	168	3.0	1.9	22.0	8	5.29
Williams WMB	3372.8	-29	9487.0	-28	16.1	-20	-3.4	NM	0.5	0.4	-2.2	NM	-0.17
World Fuel Services INT	1579.4	142	3868.5	98	7.0	26	19.8	22	0.4	0.8	14.2	16	2.19
XTO Energy XTO	507.7	58	1347.6	57	140.8	37	334.0	49	27.7	31.9	16.1	21	1.61
FINANCIALS													
SECTOR COMPOSITE	294208.9	14	854081.0	12	38190.0	18	114777.0	19	13.0	12.6	13.6	14	3.06
10 FINANCIALS													
INDUSTRY GROUP COMPOSITE	67477.0	13	191457.0	8	14057.1	11	40942.9	13	20.8	21.1	15.4	14	3.20
(A) COMMERCIAL BANKS													
INDUSTRY COMPOSITE	56577.6	15	161590.9	11	12137.3	22	35120.3	19	21.5	20.2	15.4	14	3.15
AmSouth Bancorporation ASO	763.4**	4	2251.4	2	119.6	-24	446.6	-4	15.7	21.4	17.5	16	1.70
Bank of America BAC	17145.0	37	47172.0	28	3764.0	29	10294.0	27	22.0	23.3	13.3	13	3.67
Banknorth Group BNK	416.9	10	1196.4	1	97.8	8	283.9	10	23.5	23.8	12.3	16	2.19
BB&T BBT	1697.8	5	4949.5	7	412.9	256	1141.5	50	24.3	7.2	13.7	16	2.61
Comerica CMA	764.0	-5	2293.0	-9	196.0	25	550.0	9	25.7	19.6	14.1	15	4.04

CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS				RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE-EARNINGS RATIO AS OF 11-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %					
Commerce Bancorp CBH	420.9**	32	1163.5	29	70.1	42	198.3	44	16.7	15.5	16.5	19	3.09		
Compass Bancshares CBSS	488.7	8	1404.3	4	93.6	8	271.6	6	19.2	19.2	18.7	17	2.86		
Fifth Third Bancorp FITB	1654.0	5	5019.0	3	471.0	10	1349.0	10	28.5	27.0	21.1	16	3.17		
First Horizon National FHN	627.8	-6	1882.1	-10	113.6	-4	351.3	-1	18.1	17.7	23.7	12	3.63		
Hibernia HIB	365.6	6	1015.0	6	76.5	10	215.8	16	20.9	20.0	15.2	16	1.84		
Huntington Bancshares HBAN	527.9	-11	1623.8	-9	93.5	-10	307.8	5	17.7	17.6	16.3	14	1.72		
KeyCorp KEY	1388.0	-3	4116.0	-4	252.0	11	741.0	11	18.2	15.8	14.0	15	2.33		
M&T Bank MTB	828.0	4	2395.2	10	186.4	19	530.3	30	22.5	19.7	12.2	19	5.74		
Marshall & Ilsley MI	792.1	14	2222.7	8	155.4	11	453.3	12	19.6	20.2	16.6	16	2.63		
National City NCC	2639.1	30	7362.1	2	590.7	72	1820.1	16	22.4	16.9	18.9	11	3.73		
North Fork Bancorporation NFB	379.4**	27	1027.3	7	119.7	27	331.2	13	31.6	31.7	17.6	17	2.74		
PNC Financial Services Group PNC	1523.0	2	4668.0	5	258.0	-8	890.0	22	16.9	18.8	16.9	13	4.21		
Popular BPOP	708.3	4	2063.5	3	115.4	-12	361.7	-1	16.3	19.2	17.6	15	1.71		
Regions Financial RF	1463.8	65	3250.2	18	256.7	56	587.3	20	17.5	18.5	7.0	15	2.32		
SouthTrust SOTR	752.9	0	2301.0	0	188.3	5	566.0	8	25.0	23.8	16.7	NA	2.22		
Synovus Financial SNV	684.0	12	1979.4	9	109.0	9	318.3	11	15.9	16.3	16.3	20	1.37		
U.S. Bancorp USB	3826.8	10	10881.1	-1	1065.5	13	3110.8	14	27.8	27.0	20.8	14	2.12		
UnionBanCal UB	678.2	5	2106.4	10	163.4	5	552.0	27	24.1	23.9	17.1	13	4.70		
Wachovia WB	6893.0**	9	20267.0	13	1263.0	16	3766.0	20	18.3	17.2	14.4	14	3.68		
Wells Fargo WFC	8305.0**	2	24529.0	4	1748.0	12	5229.0	14	21.0	19.1	18.7	15	4.00		
Westcorp WES	351.3**	4	1032.2	2	54.7	86	152.5	80	15.6	8.7	14.9	11	3.70		
Zions Bancorporation ZION	492.6	-9	1419.7	-1	102.5	60	301.0	23	20.8	11.9	14.6	15	4.36		
(B) THRIFTS & MORTGAGE FINANCE															
INDUSTRY COMPOSITE	10899.3	2	29866.1	-6	1919.8	-29	5822.5	-12	17.6	25.4	15.5	12	3.57		
Countrywide Financial CFC	4098.5	8	10572.1	-3	582.2	-47	1972.8	9	14.2	28.9	25.3	8	4.10		
Golden West Financial GDW	1144.5**	18	3203.0	12	324.8	15	941.2	15	28.4	29.2	17.9	15	7.95		
MGIC Investment MTG†	391.0	-9	1209.6	-5	134.1	28	418.7	7	34.3	24.6	12.7	12	5.30		
Radian Group RDN†	329.2	-1	984.9	6	122.2	7	362.7	10	37.1	34.2	12.0	11	4.42		
Sovereign Bancorp SOV	714.1**	19	1980.5	7	82.5	-24	316.1	9	11.6	18.1	8.9	16	1.37		
Washington Mutual WM	4222.0	-7	11916.0	-14	674.0	-33	1811.0	-39	16.0	21.9	12.6	13	2.96		
1 FINANCIALS															
INDUSTRY GROUP COMPOSITE	102034.9	17	297699.3	13	14596.6	7	40505.8	7	14.3	15.6	13.8	15	2.86		
(A) CAPITAL MARKETS															
INDUSTRY COMPOSITE	40200.2	11	123364.8	15	4764.6	1	17006.1	35	11.9	13.0	16.0	14	3.14		
Bank of New York BK	1739.0**	6	5177.0	11	354.0	36	1089.0	28	20.4	15.9	15.4	19	1.80		
Bear Stearns BSC (1)	1894.4	3	6039.6	9	283.3	-10	992.1	14	15.0	17.0	16.4	10	9.34		
E*Trade Financial ET	476.8	-7	1518.5	4	79.8	28	261.0	172	16.7	12.1	17.1	14	0.95		
Edwards (A.G.) AGE (10)	614.9	-4	1971.1	15	40.6	8	141.3	63	6.6	5.9	10.5	17	2.25		
Franklin Resources BEN (3)	881.7**	22	2632.0	30	199.9	31	546.6	39	22.7	21.0	14.0	22	2.83		
Goldman Sachs Group GS (1)	6803.0	19	22384.0	26	879.0	30	3359.0	65	12.9	11.8	18.4	12	8.45		
Legg Mason LM (9)	585.5	24	1716.9	32	91.7	54	270.0	63	15.7	12.6	21.3	21	3.09		
Lehman Brothers Holdings LEH (1)	5051.0	13	15404.0	18	505.0	5	1784.0	46	10.0	10.8	16.8	11	7.65		
Mellon Financial MEL	1132.0	0	3566.0	6	181.0	18	601.0	22	16.0	13.5	19.8	16	1.85		
Merrill Lynch MER	7595.0	11	22942.0	9	920.0	-8	3250.0	24	12.1	14.6	15.1	13	4.44		
Morgan Stanley MWD (1)	9854.0	10	29129.0	13	862.0	-17	3310.0	18	8.7	11.6	15.8	14	3.91		
Northern Trust NTRS	686.7**	6	2063.5	6	114.7	0	372.7	27	16.7	17.8	15.6	20	2.25		
Raymond James Financial RJF (3)	462.2	12	1405.1	22	30.7	-7	103.3	44	6.6	8.0	12.0	17	1.72		
Schwab (Charles) SCH	1000.0**	0	3142.0	11	46.0	-63	312.0	-5	4.6	12.4	8.1	28	0.34		
State Street STT	1424.0**	10	4274.0	14	177.0	-12	614.0	123	12.4	15.6	17.2	15	3.13		
(B) CONSUMER FINANCE															
INDUSTRY COMPOSITE	15254.4	11	44638.3	9	2631.9	20	7635.5	26	17.3	15.9	22.5	16	2.59		
American Express AXP	7202.0**	12	21370.0	14	879.0	14	2620.0	18	12.2	12.0	21.2	21	2.63		
AmeriCredit ACF (6)	340.0	18	986.1	26	68.8	106	215.3	512	20.2	11.6	12.2	12	1.64		
Capital One Financial COF	2767.8	12	7923.7	9	490.2	69	1348.4	52	17.7	11.8	20.4	12	6.56		
MBNA KRB	3161.8	5	9104.6	7	728.3	11	1908.4	17	23.0	21.9	21.9	13	2.00		
Provident Financial PVN	705.5**	4	2021.9	-5	109.1	28	280.5	117	15.5	12.5	13.2	14	1.11		
SLM SLM	1077.4	15	3232.0	-6	356.6	2	1263.0	11	33.1	37.5	55.4	15	3.37		
(C) DIVERSIFIED FINANCIAL SERVICES															
INDUSTRY COMPOSITE	46580.3	25	129696.2	13	7200.0	7	15864.2	-17	15.5	18.1	10.6	16	2.75		
CIT Group CIT	1179.8	3	3465.5	0	183.9	24	549.8	34	15.6	12.9	12.1	12	3.28		
Citigroup C	26408.0**	13	79671.0	13	5308.0	13	11725.0	-10	20.1	20.1	16.9	15	3.15		
JPMorgan Chase JPM	16546.0	59	39448.0	17	1418.0	-13	2800.0	-42	8.6	15.6	4.4	20	1.95		
Moody's MCO	357.9	17	1046.7	17	95.5	12	302.5	9	26.7	28.1	263.1	31	2.56		
Principal Financial Group PFG	2088.6	6	6065.0	4	194.6	15	486.9	16	9.3	8.6	8.8	18	2.16		
12 INSURANCE															
INDUSTRY GROUP COMPOSITE	119358.0	13	349309.3	13	9245.7	60	32015.3	52	7.7	5.4	12.2	13	3.66		
ACE ACE	3072.0	15	9034.0	20	-3.0	NM	857.0	-12	NM	13.3	13.6	9	4.41		
AFLAC AFL	3321.0	13	9834.0	14	301.0	27	881.0	22	9.1	8.1	15.4	20	1.84		

CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RET. ON EQUITY 12 MONTHS ENDING 9-3	P/E RATIO 9-4	DIV. YIELD PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD Q-ARTER 2004 %	3RD QUARTER 2003 %			
Allstate ALL	8442.0	4	25057.0	5	56.0	-92	2214.0	14	0.7	8.5	14.2	12	3.99
Ambac Financial Group ABK	351.7**	10	1040.3	12	184.4	15	537.1	17	52.4	50.1	14.6	12	6.37
American Financial Group AFG	1066.8**	27	2819.4	15	176.8	329	307.5	221	16.6	4.9	23.2	4	7.21
American International Group AIG	23394.8**	27	66818.8	25	2512.5	8	8211.8	25	10.7	12.7	13.8	15	4.15
American National Insurance ANAT	767.7	15	2270.8	18	47.0	7	175.8	60	6.1	6.6	7.8	11	9.36
AmerUs Group AMH	408.0**	9	1146.8	-7	42.9	6	121.4	2	10.5	10.8	10.5	11	4.01
Aon AOC	2402.0	1	7510.0	5	121.0	-15	493.0	7	5.0	6.0	14.9	10	2.15
Assurant AIZ	1817.3	3	5492.7	6	74.8	-25	264.4	0	4.1	5.7	6.9	22	1.21
Berkley (W.R.) BER	1139.5	24	3329.0	26	97.1	27	322.7	32	8.5	8.3	21.0	9	4.72
Chubb CB	3290.9**	9	9595.0	15	364.0	40	1080.8	47	11.1	8.6	13.0	12	5.99
Cincinnati Financial CINF	879.0	5	2672.0	14	90.0	-13	392.0	60	10.2	12.4	8.5	14	3.06
CNA Financial CNA	2317.0**	-15	7245.0	-16	-28.0	NM	136.0	NM	NM	NM	3.0	25	1.02
Commerce Group CGI	448.8	11	1330.7	10	54.3	138	142.7	33	12.1	5.6	18.8	9	6.00
Everest Re Group RE	1263.6	13	3646.5	26	11.5	-89	401.5	32	0.9	9.0	14.8	9	9.22
Fidelity National Financial FNF	2159.9	-3	6200.9	9	193.8	-30	566.1	-15	9.0	12.4	16.5	9	4.39
First American FAF	1721.5**	0	4919.3	7	107.2	-24	278.7	-22	6.2	8.3	15.7	8	4.14
Gallagher (Arthur J.) AJG	373.0	8	1093.4	22	54.4	11	139.4	44	14.6	14.2	25.4	14	2.01
Genworth Financial GNW	2470.0	-15	8415.0	-2	271.0	18	799.0	7	11.0	7.9	8.4	12	2.08
Hartford Financial Services Group HIG	5416.0	9	16592.0	19	494.0	44	1518.0	NM	9.1	6.9	16.1	9	6.71
Jefferson-Pilot JP	1002.1	11	3034.1	13	133.8	6	417.0	11	13.4	13.9	15.2	13	3.81
LandAmerica Financial Group LFG	876.6	-3	2578.0	4	33.5	-47	115.9	-31	3.8	7.0	12.6	6	7.63
Lincoln National LNC	1406.1	11	4023.8	12	199.7	50	541.6	71	14.2	10.5	18.0	8	5.51
Loews LTR	3617.5**	-4	10697.5	-8	277.6	NM	728.5	NM	7.7	NM	9.6	13	5.03
Markel MKL	573.0	11	1697.7	12	13.8	NM	115.1	46	2.4	NM	10.6	20	16.21
MBIA MBI	478.1	9	1469.6	14	186.0	-2	608.1	-3	38.9	43.1	12.1	11	5.44
Mercury General MCY	677.1	18	1953.0	18	65.1	31	212.1	57	9.6	8.6	18.6	11	4.78
MetLife MET	10048.0**	15	28961.0	12	699.0	27	2202.0	57	7.0	6.3	11.8	11	3.65
Nationwide Financial Services NFS	1063.3**	3	3088.2	5	136.4	9	363.6	24	12.8	12.2	9.1	12	3.06
Odyssey Re Holdings ORH	669.8	19	1934.0	12	18.0	-57	136.0	-33	2.7	7.5	13.1	8	2.82
Ohio Casualty OCAS	397.4	-5	1231.7	-1	19.6	14	73.1	52	4.9	4.1	8.0	13	1.59
Old Republic International ORI	880.3	2	2569.8	6	109.1	-9	334.5	-3	12.4	13.8	11.8	10	2.43
PartnerRe PRE	1056.0	9	3104.9	10	83.2	-29	348.7	-4	7.9	12.1	15.4	7	8.01
Phoenix PNK	660.9**	-5	2001.6	4	7.1	-48	38.0	NM	1.1	1.9	3.3	16	0.67
Progressive PGR	3434.3	12	10075.8	16	388.9	22	1235.2	38	11.3	10.4	27.8	13	7.25
Prudential Financial PRU	7327.0	9	20960.0	1	730.0	127	1744.0	145	10.0	4.8	11.3	13	3.74
Reinsurance Group of America RGA	959.5	35	2915.1	40	58.0	37	189.4	59	6.0	5.9	12.7	11	4.07
Safeco SAFC	1566.9	14	4621.0	15	5.9	NM	440.4	201	0.4	NM	16.3	11	4.39
Selective Insurance Group SIGI	396.2	15	1153.4	16	28.3	92	84.7	99	7.2	4.3	13.0	12	3.56
St. Paul Travelers STA	6261.0	67	16569.0	49	340.0	-20	652.0	-46	5.4	11.4	5.8	16	2.21
StanCorp Financial Group SFG	541.4	3	1591.4	2	52.0	23	148.1	32	9.6	8.1	13.9	12	6.62
Stewart Information Services STC	529.7**	-16	1560.0	-4	21.1	-50	62.2	-40	4.0	6.7	12.1	10	4.57
Torchmark TMK	774.2	6	2310.7	6	124.1	15	353.0	11	16.0	14.8	15.0	13	4.12
Transatlantic Holdings TRH	1021.3	9	2964.3	17	-21.8	NM	155.6	-29	NM	8.6	9.7	16	3.63
21st Century Insurance Group TW	348.4	10	1030.1	13	24.6	93	65.8	87	7.0	4.0	11.2	13	0.99
UICI UCI	513.2	13	1519.8	17	33.3	141	101.9	115	6.5	3.0	21.0	11	2.98
Unitrin UTR	778.7	3	2281.1	4	56.5	31	166.9	111	7.3	5.7	10.8	15	3.07
UnumProvident UNM	2655.3	4	7788.3	4	167.6	70	-326.7	NM	6.3	3.8	-8.6	NM	-1.84
XL Capital XL†	2322.4	20	7561.6	36	32.6	-70	868.5	21	1.4	5.6	7.4	19	3.76

13 REAL ESTATE

INDUSTRY GROUP COMPOSITE	5339.0	17	15615.4	18	290.6	-21	1313.0	2	5.4	8.0	5.6	42	0.83
Apartment Investment & Management AIV	383.1	7	1109.3	5	27.0	134	33.0	-42	7.0	3.2	-2.0	NM	-0.48
Boston Properties BXP	360.2	9	1040.6	7	64.3	15	194.3	-14	17.9	17.0	8.8	25	2.41
CB Richard Ellis Group CBG	575.0	36	1566.9	55	11.9	NM	-1.7	NM	2.1	NM	-2.5	NM	-0.19
Equity Office Properties Trust EOP	807.7	1	2417.8	1	-125.2	NM	83.2	-76	NM	13.7	2.6	43	0.66
Equity Residential EQR	495.0	12	1427.4	9	29.0	-35	110.6	-19	5.9	10.1	1.7	91	0.37
General Growth Properties GGP†	417.5	21	1188.6	26	63.0	5	171.6	9	15.1	17.4	16.3	27	1.25
Host Marriott HMT	810.0	11	2540.0	9	-46.0	NM	-82.0	NM	NM	NM	-11.3	NM	-0.70
New Century Financial NEW†	480.1	87	1255.9	92	107.3	65	296.9	73	22.3	25.3	45.4	7	8.96
Plum Creek Timber PCL	363.0	25	1201.0	36	77.0	71	289.0	113	21.2	15.5	15.5	21	1.87
Simon Property Group SPG†	647.4	11	1867.9	9	82.4	19	218.2	2	12.7	11.8	11.0	38	1.59



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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS				EARNINGS PER SHARE 12 MONTHS ENDING 9-30	PRICE PER SHARE AS OF 11-4	% CHG EARN/PR PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %					
HEALTH CARE															
INDUSTRY COMPOSITE	213515.6	14	623594.1	15	18248.8	27	52608.8	40	8.5	7.7	17.1	23	1.73		
14 HEALTH CARE EQUIPMENT & SERVICES															
INDUSTRY GROUP COMPOSITE	154997.7	17	450236.7	16	6268.2	20	18828.5	26	4.0	4.0	15.1	22	2.05		
(A) HEALTH CARE EQUIPMENT & SUPPLIES															
INDUSTRY COMPOSITE	16286.3	18	48037.6	18	2103.5	15	5834.1	21	12.9	13.2	16.4	32	1.48		
Bard (C.R.) BCR	421.9	17	1232.0	17	102.4	99	233.0	58	24.3	14.2	21.2	25	2.36		
Bausch & Lomb BOL	548.9	8	1625.7	11	43.3	34	108.1	40	7.9	6.3	12.0	21	2.92		
Baxter International BAX	2320.0	5	6908.0	8	259.0	-6	277.0	-48	11.2	12.4	17.8	29	1.07		
Beckman Coulter BEC	581.2	9	1715.3	10	57.2	43	151.1	10	9.8	7.5	22.8	18	3.37		
Becton, Dickinson BDx (3)	1253.3	8	3781.6	9	183.3	13	457.9	5	14.6	14.0	19.1	23	2.21		
Biomet BMET (7)	438.2	18	1295.5	18	60.4	-21	226.9	0	13.8	20.7	22.1	40	1.21		
Boston Scientific BSX	1482.0	69	4024.0	59	258.0	108	765.0	128	17.4	14.2	22.5	35	1.05		
Dade Behring Holdings DADE	369.4	9	1139.8	9	17.2	76	55.9	57	4.7	2.9	8.7	35	1.53		
Dentsply International XRAY	390.6	4	1231.3	8	46.3	15	141.3	17	11.9	10.7	14.5	23	2.33		
Fisher Scientific International FSH	1263.0	42	3331.6	29	10.8	-61	90.1	51	0.9	3.1	2.8	40	1.39		
Guidant GDT	924.5	0	2797.4	3	160.7	11	449.3	104	17.4	15.8	18.8	32	2.03		
Invacare IVC	349.5	7	1010.1	12	22.5	13	54.8	15	6.4	6.1	11.7	19	2.44		
Medtronic MDT (8)	2346.1	14	7205.3	18	529.7	18	1562.5	14	22.6	21.8	21.6	31	1.67		
PerkinElmer PKI	403.4	10	1208.6	10	24.6	67	60.3	99	6.1	4.0	6.2	31	0.68		
St. Jude Medical STJ	578.3	21	1683.5	19	91.2	8	285.2	17	15.8	17.7	18.3	37	2.05		
Stryker SYK	1028.7	16	3106.8	18	14.4	-87	303.0	-5	1.4	12.2	17.5	41	1.07		
Thermo Electron TMO	542.3	21	1592.7	16	42.6	9	132.9	4	7.9	8.7	7.5	27	1.09		
Varian Medical Systems VAR (3)	344.8	14	968.6	16	51.8	19	138.0	26	15.0	14.4	27.2	34	1.18		
Zimmer Holdings ZMH	700.2	76	2179.8	82	127.9	50	341.8	34	18.3	21.3	10.4	52	1.53		
(B) HEALTH CARE PROVIDERS & SERVICES															
INDUSTRY COMPOSITE	138711.5	17	402199.1	15	4164.8	22	12994.4	28	3.0	2.9	14.6	17	2.51		
Accredo Health ACDO (6)	415.5	24	1206.1	18	12.9	-27	53.8	235	3.1	5.2	11.9	17	1.50		
Aetna AET	5039.5**	13	14735.8	10	302.3	40	914.4	34	6.0	4.8	12.8	14	7.33		
Amerigroup AGP	471.0	14	1333.4	11	24.3	34	63.6	28	5.2	4.4	15.1	19	3.16		
AmerisourceBergen ABC (3)	13388.7	6	39823.8	7	92.0	-23	359.9	3	0.7	0.9	10.8	14	4.06		
Anthem ATH	4803.0	13	13981.6	12	242.1	23	775.6	37	5.0	4.6	14.5	12	6.90		
Apria Healthcare Group AHG	364.6	5	1075.0	5	29.8	3	86.7	1	8.2	8.3	31.2	13	2.30		
Cardinal Health CAH (5)	17796.0	16	51110.5	14	217.8	-33	1045.3	-1	1.2	2.1	17.2	14	3.25		
Caremark Rx CMX	7457.9	230	17788.3	169	171.8	124	395.2	90	2.3	3.4	6.4	27	1.28		
Cigna CI	4479.0**	-6	13834.0	-3	320.0	64	1052.0	219	7.1	4.1	29.2	7	9.61		
Community Health Systems CYH	844.0	18	2461.0	22	37.6	19	117.6	22	4.5	4.4	12.9	19	1.49		
Coventry Health Care CVH	1329.8	16	3927.8	19	87.0	29	245.4	36	6.5	5.9	28.5	12	3.47		
D&K Healthcare Resources DKHR (6)	725.7	52	2277.4	39	-1.9	NM	6.6	-33	NM	0.3	3.8	17	0.47		
DaVita DVA	595.5	16	1682.6	15	60.4	59	165.7	47	10.1	7.4	50.5	14	2.22		
Express Scripts ESRX	3767.7	16	11175.0	14	61.9	-4	197.3	8	1.6	2.0	20.8	21	3.39		
HCA HCA	5792.0	6	17562.0	8	227.0	-26	924.0	-9	3.9	5.6	19.0	15	2.51		
Health Management Associates HMA (3)	798.1	21	2449.3	26	74.0	6	253.8	13	9.3	10.6	16.4	16	1.32		
Health Net HNT	2935.2	4	8778.8	6	71.9	-17	128.2	-45	2.4	3.1	16.1	13	1.90		
Humana HUM	3176.3**	2	9894.7	9	84.3	36	232.9	43	2.7	2.0	14.8	12	1.84		
IMS Health RX	384.2	11	1125.3	13	65.6	-5	211.8	197	17.1	20.0	150.7	19	1.17		
Kindred Healthcare KND	889.4	7	2643.8	9	18.4	-4	59.8	63	2.1	2.3	11.6	13	1.79		
Laboratory Corp. of America Holdings LH	781.5	4	2318.3	5	92.6	11	278.2	14	11.8	11.1	18.0	19	2.51		
Magellan Health Services MGLN	458.0	23	1350.2	15	27.2	NM	68.5	NM	5.9	NM	117.6	3	13.52		
Manor Care HCR	806.8	6	2403.3	7	39.1	26	120.3	48	4.8	4.1	16.3	19	1.77		
McKesson MCK (9)	19934.3	19	57060.8	18	86.1	-45	463.9	-6	0.4	0.9	10.6	14	1.98		
Medco Health Solutions MHS	8696.6	2	26438.7	5	118.1	18	348.9	13	1.4	1.2	8.5	22	1.70		
Molina Healthcare MOH	330.8	67	799.9	37	16.4	40	39.5	29	5.0	5.9	16.4	21	1.91		
Omnicare OCR	1053.9	17	3046.8	19	55.9	14	179.8	35	5.3	5.4	12.9	12	2.31		
Owens & Minor OMI	1134.4	7	3359.8	7	15.2	18	45.1	15	1.3	1.2	13.2	18	1.50		
PacifiCare Health Systems PHS	3105.6	13	9117.2	11	88.2	31	231.2	9	2.8	2.5	12.7	15	2.80		
Patterson Companies PDCO (8)	577.9	33	1636.5	26	40.8	39	126.0	35	7.1	6.8	18.9	33	1.17		
Priority Healthcare PHCC	440.2	21	1279.9	20	12.6	4	37.0	1	2.9	3.4	13.2	16	1.16		
PSS World Medical PSSI (9)	364.2	5	1046.0	10	8.8	6	22.1	71	2.4	2.4	12.4	26	0.45		
Quest Diagnostics DGX	1289.9	6	3843.3	9	130.1	8	373.1	14	10.1	9.8	19.4	20	4.58		
Renal Care Group RCI	356.1	40	975.0	31	30.5	15	89.7	21	8.6	10.5	21.4	20	1.65		
Schein (Henry) HSIC	1033.6	16	2865.9	19	31.5	-32	98.6	-5	3.0	5.2	12.7	21	2.99		
Select Medical SEM	407.6	16	1241.3	25	27.7	49	87.6	69	6.8	5.3	23.1	17	1.03		
Sierra Health Services SIE	393.3**	1	1242.7	12	30.7	39	95.3	64	7.8	5.7	65.3	14	3.55		
Sunrise Senior Living SRZ	370.3	11	1082.3	42	8.9	-48	38.0	-19	2.4	5.1	10.6	17	2.34		
Tenet Healthcare THC	2440.0	-3	7544.0	-2	-52.0	NM	-202.0	NM	NM	NM	-35.6	NM	-2.94		
Triad Hospitals TRI	1112.4	20	3310.7	22	43.4	309	87.3	-7	3.9	1.1	4.0	30	1.17		
UnitedHealth Group UNH	9859.0**	36	26707.0	25	698.0	47	1848.0	40	7.1	6.6	21.3	21	3.68		



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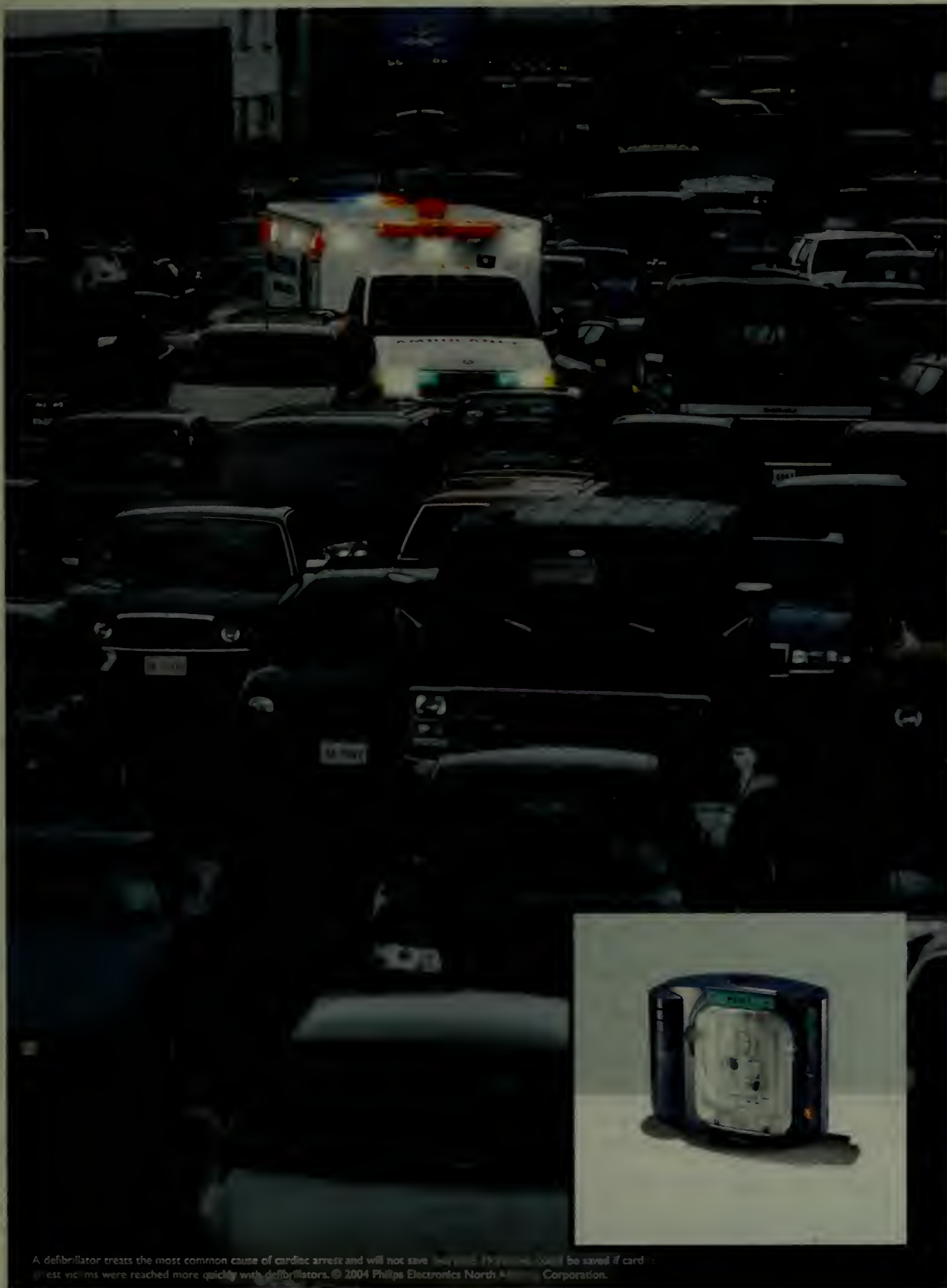
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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-10	PRICE EARNINGS RATIO 10/4	MONTHLY EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Universal Health Services UHS	1012.9**	16	3049.0	16	38.8	-13	131.9	-13	3.8	5.1	14.7	16	2.82
WellChoice WC	1451.0**	8	4339.6	8	61.9	19	186.6	26	4.3	3.9	14.8	16	2.86
WellPoint Health Networks WLP	5848.1**	16	17274.6	16	315.1	28	910.2	37	5.4	4.9	18.3	14	7.41
15 PHARMACEUTICALS & BIOTECHNOLOGY													
INDUSTRY GROUP COMPOSITE	58517.9	8	173357.4	14	11980.6	32	33780.3	49	20.5	16.7	18.6	23	1.59
(A) BIOTECHNOLOGY													
INDUSTRY COMPOSITE	6188.8	32	17584.6	37	775.7	-8	3038.2	29	12.5	18.0	7.5	67	0.74
Amgen AMGN	2713.0	23	7641.0	27	236.0	-61	1674.0	-2	8.7	27.7	11.2	35	1.69
Applied Biosystems Group ABI (6)	390.3	2	1290.3	5	37.1	11	123.6	-27	9.5	8.7	14.2	23	0.85
Biogen Idec BIIB	543.3	292	1623.8	328	36.8	-19	-3.6	NM	6.8	32.8	-14.8	NM	-4.04
Chiron CHIR†	444.2	-14	1158.6	4	23.9	NM	83.0	-19	5.4	NM	8.2	31	1.04
Genentech DNA	1202.6	47	3305.9	40	230.9	16	578.2	20	19.2	24.4	10.1	75	0.65
Genzyme General GENZ	569.2	30	1610.1	47	97.8	NM	243.9	559	17.2	NM	9.1	42	1.30
Gilead Sciences GILD	326.2	63	955.0	58	113.2	55	339.1	NM	34.7	36.5	38.1	32	1.17
(B) PHARMACEUTICALS													
INDUSTRY COMPOSITE	52329.0	5	155772.8	12	11204.9	36	30742.1	52	21.4	16.6	21.3	20	1.74
Abbott Laboratories ABT	4681.7	10	14025.6	13	804.1	15	2201.2	37	17.2	16.4	24.5	22	2.00
Allergan AGN	510.8	15	1489.4	17	92.0	21	264.6	591	18.0	17.1	17.4	58	1.30
Bristol-Myers Squibb BMY	5427.0	1	16038.0	5	758.0	-16	2249.0	-14	14.0	16.9	26.4	17	1.40
Forest Laboratories FRX (9)	856.7**	38	2364.2	28	295.3	60	670.7	23	34.5	29.8	25.7	17	2.37
IVAX IVX	439.1	22	1328.2	30	44.4	105	134.8	93	10.1	6.0	14.0	21	0.65
Johnson & Johnson JNJ	11553.0	11	34596.0	13	2341.0	13	7292.0	36	20.3	19.8	30.4	19	3.05
King Pharmaceuticals KG	353.5	-16	919.2	-19	29.3	-73	-38.6	NM	8.3	25.7	0.2	NM	0.01
Lilly (Eli) LLY	3280.4	4	10213.6	12	755.2	6	1812.5	0	23.0	22.8	22.6	24	2.35
Merck MRK	5538.1	-4	17190.7	2	1325.6	-29	4712.3	-9	23.9	32.4	36.0	10	2.74
Pfizer PFE	12831.0	4	37593.0	22	3298.0	47	8461.0	732	25.7	18.1	13.6	24	1.19
Schering-Plough SGP	1978.0	-1	6088.0	-5	26.0	NM	-112.0	NM	1.3	NM	-4.5	NM	-0.20
Watson Pharmaceuticals WPI	408.0	14	1217.0	16	14.6	-72	96.2	-36	3.6	14.3	6.8	20	1.35
Wyeth WYE	4471.8	10	12709.8	10	1421.3	NM	2998.3	75	31.8	NM	33.6	16	2.49
INDUSTRIALS													
SECTOR COMPOSITE	292035.3	15	845195.7	15	16029.7	26	44598.8	29	5.5	5.0	13.5	24	1.74
16 CAPITAL GOODS													
INDUSTRY GROUP COMPOSITE	197500.8	16	571810.4	15	12987.0	30	37434.6	37	6.6	5.9	15.1	21	2.08
(A) AEROSPACE & DEFENSE													
INDUSTRY COMPOSITE	60157.7	11	178598.0	14	3016.7	37	8607.4	62	5.0	4.1	14.7	19	2.87
Alliant Techsystems ATK (9)	673.1	19	1994.1	14	29.9	-18	108.4	3	4.4	6.5	24.4	16	3.88
Boeing BA	13152.0	8	39143.0	6	438.0	77	1638.0	NM	3.3	2.0	28.8	15	3.41
General Dynamics GD	4754.0	8	14266.0	21	323.0	27	888.0	24	6.8	5.8	17.2	18	5.81
Goodrich GR	1166.5	10	3462.6	6	49.9	47	119.3	650	4.3	3.2	10.9	28	1.19
Honeywell International HON	6395.0	11	18961.0	12	372.0	8	1028.0	10	5.8	6.0	12.8	21	1.66
L-3 Communications Holdings LLL	1784.2	41	4985.8	39	102.5	35	262.6	47	5.7	6.0	11.3	20	3.35
Lockheed Martin LMT	8438.0	4	25561.0	12	307.0	41	894.0	26	3.6	2.7	17.1	20	2.77
Northrop Grumman NOC	7408.0	11	22007.0	14	291.0	46	821.0	43	3.9	3.0	6.4	19	2.81
Precision Castparts PCP (9)	697.5	69	2070.7	55	57.2	110	149.2	51	8.2	6.6	10.1	23	2.78
Raytheon RTN	4936.0	13	14541.0	12	186.0	786	193.0	-39	3.8	0.5	4.1	39	0.96
Rockwell Collins COL (3)	839.0	13	2302.0	16	86.0	18	233.0	11	10.3	9.8	26.6	23	1.67
United Defense Industries UDI	573.4	13	1696.8	11	52.2	40	134.9	21	9.1	7.4	84.2	13	3.08
United Technologies UTX	9341.0**	17	27607.0	23	722.0	13	2138.0	21	7.7	8.0	20.9	18	5.39
(B) BUILDING PRODUCTS													
INDUSTRY COMPOSITE	8982.4	13	25829.6	16	599.9	31	1598.2	41	6.7	5.8	21.9	16	2.26
American Standard ASD	2396.1	7	7156.4	11	156.0	27	400.3	25	6.5	5.5	50.6	18	2.19
Griffon GFF (3)	369.7	2	1055.3	11	18.9	17	40.7	27	5.1	4.5	17.5	14	1.71
Masco MAS	3173.0	12	9040.0	16	289.0	12	824.0	30	9.1	9.1	18.3	18	2.00
Universal Forest Products UFPI	709.3	32	1917.5	33	14.6	20	39.9	18	2.1	2.3	13.3	16	2.47
USG USG	1175.0	22	3340.0	22	90.0	131	227.0	147	7.7	4.1	29.1	5	6.35
York International YRK	1159.3	15	3320.3	12	31.3	214	66.2	326	2.7	1.0	7.4	23	1.49
(C) CONSTRUCTION & ENGINEERING													
INDUSTRY COMPOSITE	8086.3	12	22766.7	7	154.5	4	371.8	8	1.9	2.1	7.3	25	1.01
Emcor Group EME	1215.9	5	3518.2	5	15.5	139	22.6	26	1.3	0.6	4.6	26	1.63
Fluor FLR	2362.7	11	6640.4	3	47.3	7	138.8	8	2.0	2.1	15.5	19	2.31
Granite Construction GVA	699.8	21	1595.6	18	32.8	27	37.5	-20	4.7	4.5	9.6	21	1.25
Jacobs Engineering Group JEC (3)	1215.7	14	3459.1	2	30.5	-9	95.2	-3	2.5	3.2	12.8	19	2.25
Perini PCR	467.7	58	1443.9	65	6.4	1	29.8	39	1.4	2.2	35.0	7	2.09
Quanta Services PWR	463.1	6	1207.3	0	4.2	-23	-11.0	NM	0.9	1.2	-5.6	NM	-0.33
Shaw Group SGR (4)	823.2	8	2427.7	6	10.6	17	23.3	485	1.3	1.2	-3.0	NM	-0.45
URS URS (2)	838.2	8	2474.5	5	7.3	-57	35.6	-8	0.9	2.2	5.3	19	1.48



A defibrillator treats the most common cause of cardiac arrest and will not save lives if the person will be saved if cardiac arrest victims were reached more quickly with defibrillators. © 2004 Philips Electronics North America Corporation.

After cardiac arrest, you need help within 5 minutes. The ambulance usually takes 9.

Philips HeartStart Home Defibrillator. For the best chance of survival a shock should be delivered within five minutes. But most sudden cardiac arrests happen at home, where help often doesn't arrive in time. So Philips designed a defibrillator for the home that can be used by people just like you. Now you can help save a life by about the time it takes to head to a doctor. It just makes sense. Call 1-866-333-4246 for more information on the HeartStart Home Defibrillator. Join us on our journey at www.philips.com/simplicity

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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON		12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %	ROA 12 MONTHS 2004	ROE 12 MONTHS 2004	
(D) ELECTRICAL EQUIPMENT													
INDUSTRY COMPOSITE	9269.9	13	26925.9	12	719.2	35	1965.7	28	7.8	6.5	15.8	22	2.15
Acuity Brands AYI ⁽⁴⁾	563.4	6	1586.6	3	26.8	87	54.3	46	4.8	2.7	14.1	18	1.56
American Power Conversion APCC	441.7	12	1189.1	15	67.2	20	128.6	8	15.2	14.2	12.9	22	0.92
Cooper Industries CBE	1140.2	9	3314.1	10	89.3	26	250.9	26	7.8	6.7	15.2	19	3.43
Emerson Electric EMR ⁽³⁾	4120.0	12	12015.0	12	354.0	28	1013.0	27	8.6	7.5	17.4	23	2.98
General Cable BGC	489.3	28	1485.4	31	7.4	252	10.7	106	1.5	0.5	-3.0	NM	-0.14
Hubbell HUB.B	525.1	15	1493.2	13	41.5	21	106.9	33	7.9	7.5	15.8	20	2.31
Rockwell Automation ROK ⁽³⁾	1206.2	18	3482.6	13	96.6	54	301.3	26	8.0	6.1	19.3	24	1.85
Smith (A.O.) AOS	389.9	9	1243.7	7	3.0	-50	31.0	-22	0.8	1.7	7.3	19	1.46
Thomas & Betts TNB	394.2	16	1116.2	15	33.4	184	69.0	194	8.5	3.5	10.8	20	1.50
(E) INDUSTRIAL CONGLOMERATES													
INDUSTRY COMPOSITE	57708.4	14	166168.1	11	5568.7	22	16201.2	19	9.6	9.0	15.2	23	1.65
Carlisle CSL	631.3	17	1825.4	17	32.1	30	96.3	36	5.1	4.6	16.0	16	3.66
General Electric GE	38083.0**	15	108007.0	12	4051.0	1	11215.0	2	10.6	12.1	15.5	23	1.53
Teleflex TFX	625.8	14	1917.2	14	17.5	-4	81.1	2	2.8	3.3	9.8	17	2.74
Textron TXT	2569.0**	15	7470.0	4	103.0	119	240.0	21	4.0	2.1	8.6	30	2.31
3M MMM	4969.0	8	14920.0	10	775.0	17	2270.0	27	15.6	14.4	33.2	22	3.61
Tyco International TYC ⁽³⁾	10442.0	13	30934.2	12	571.0	NM	2276.0	379	5.5	NM	9.9	24	1.41
Walter Industries WLT	388.3	13	1094.2	9	19.1	NM	22.7	1	4.9	NM	1.4	NM	0.11
(F) MACHINERY													
INDUSTRY COMPOSITE	48906.1	28	139396.9	25	2821.6	45	8376.7	70	5.8	5.1	16.6	19	3.08
AGCO AG	1216.5	52	3739.2	52	34.8	111	108.1	142	2.9	2.1	10.5	12	1.66
Briggs & Stratton BGG ⁽⁶⁾	439.0	32	1639.0	17	-1.5	NM	110.0	38	NM	1.2	15.8	14	5.30
Caterpillar CAT	7649.0	38	21680.0	33	498.0	124	1484.0	98	6.5	4.0	26.1	17	5.16
Crane CR	477.3	12	1404.7	16	-205.2	NM	-151.8	NM	NM	6.6	-20.2	NM	-2.00
Cummins CMI	2194.0	34	6089.0	34	116.0	383	231.0	NM	5.3	1.5	21.7	12	6.02
Danaher DHR	1745.3	33	4909.7	29	200.8	45	528.3	44	11.5	10.6	16.7	26	2.16
Deere DE ⁽²⁾	5418.4**	23	14749.2	27	401.4	62	1049.4	83	7.4	5.6	22.3	15	4.41
Donaldson DCI ⁽⁵⁾	384.0	16	1086.8	18	26.2	-4	80.8	11	6.8	8.2	19.4	27	1.18
Dover DOV	1444.2	29	4066.9	26	116.9	55	310.3	52	8.1	6.7	13.2	21	1.91
Eaton ETN	2543.0	26	7184.0	20	170.0	59	465.0	71	6.7	5.3	17.2	18	3.69
Harsco HSC	617.3	16	1791.1	15	30.7	31	78.5	28	5.0	4.4	12.4	20	2.51
Illinois Tool Works ITW	2967.2	17	8679.8	17	330.1	22	980.4	30	11.1	10.7	16.8	23	4.12
Ingersoll-Rand IR	2368.0	15	6934.6	16	205.6	42	607.5	64	8.7	7.0	16.3	16	4.57
ITT Industries ITT	1667.7	21	4836.1	18	109.5	7	310.3	10	6.6	7.5	20.6	19	4.44
JLG Industries JLG ⁽⁵⁾	425.2	82	980.4	66	15.3	169	26.1	116	3.6	2.4	9.5	29	0.61
Joy Global JOYG ⁽²⁾	381.9	27	1003.3	20	16.3	149	36.0	956	4.3	2.2	11.7	38	0.98
Kennametal KMT ⁽⁶⁾	531.4	20	1597.5	17	22.7	159	76.6	464	4.3	2.0	9.5	20	2.38
Lincoln Electric Holdings LECO	344.3	34	982.7	27	23.0	63	65.0	60	6.7	5.5	14.6	18	1.91
Manitowoc MTW	491.1	21	1429.2	21	13.1	62	34.6	133	2.7	2.0	11.3	27	1.40
Nacco Industries NC	668.0	15	1926.5	13	13.4	15	15.3	-37	2.0	2.0	6.5	20	4.98
Navistar International NAV ⁽²⁾	2360.0	25	6550.0	23	56.0	195	88.0	NM	2.4	1.0	42.6	17	2.19
Oshkosh Truck OSK ⁽³⁾	651.1	28	1769.1	18	30.0	15	83.1	29	4.6	5.1	17.7	19	3.13
Paccar PCAR	2917.8	42	8205.9	37	246.7	86	665.4	81	8.5	6.4	22.2	16	4.68
Pall PLL ⁽⁵⁾	504.5	7	1396.5	9	55.5	2	126.9	0	11.0	11.6	14.4	22	1.20
Parker Hannifin PH ⁽⁶⁾	1947.2	23	5846.2	19	132.8	134	366.1	137	6.8	3.6	13.5	21	3.53
Pentair PNR	607.8	46	1626.7	31	33.1	23	103.3	38	5.4	6.5	9.9	28	1.37
Reliance Steel & Aluminum RS	783.7	60	2200.2	57	44.1	257	126.8	421	5.6	2.5	17.5	9	4.18
SPX SPW	1313.0	17	3808.6	17	-9.5	NM	80.1	-38	NM	5.8	9.2	18	2.36
Tecumseh Products TECUA	478.6	9	1439.8	3	12.3	-35	23.3	56	2.6	4.3	0.8	NM	0.46
Terex TEX	1251.8	38	3632.0	26	31.1	109	107.5	NM	2.5	1.6	11.4	19	2.11
Timken TKR	1096.7	17	3325.8	20	17.5	NM	71.3	410	1.6	NM	8.2	24	1.04
Toro TTC ⁽²⁾	454.0**	15	1315.6	11	34.2	27	95.7	26	7.5	6.9	23.9	18	3.89
Trinity Industries TRN	567.2	56	1570.8	54	0.9	-50	-6.3	NM	0.2	0.5	-1.0	NM	-0.23
(G) TRADING COMPANIES & DISTRIBUTORS													
INDUSTRY COMPOSITE	4390.0	16	12125.2	13	106.4	-28	313.6	-13	2.4	3.9	2.2	NM	0.31
Applied Industrial Technologies AIT ⁽⁶⁾	413.1	14	1209.3	10	13.0	170	34.5	104	3.2	1.3	11.2	19	2.00
Fastenal FAST	325.7	26	920.0	24	34.7	49	97.7	52	10.7	9.0	18.2	38	1.55
Grainger (W.W.) GWW	1301.1	8	3784.8	8	67.7	19	196.9	19	5.2	4.7	13.4	21	2.82
Hughes Supply HUG ⁽¹¹⁾	1143.1	40	2931.9	28	39.4	111	78.6	107	3.4	2.3	8.9	17	1.70
United Rentals URI	849.7	6	2270.5	7	-64.4	NM	-136.0	NM	NM	4.0	-73.0	NM	-5.71
Watsco WSO	357.4	3	1008.7	7	15.9	20	41.9	38	4.4	3.8	11.5	17	1.73
17 COMMERCIAL SERVICES & SUPPLIES													
INDUSTRY GROUP COMPOSITE	32872.3	14	94734.8	13	1949.9	64	5608.1	39	5.9	4.1	14.7	23	1.26
ABM Industries ABM ⁽²⁾	623.8**	10	1784.9	6	13.4	27	27.3	16	2.1	1.9	8.8	26	0.81
Allied Waste Industries AW	1377.7	1	4014.8	2	45.5	-6	41.1	-57	3.3	3.6	0.8	NM	-2.21



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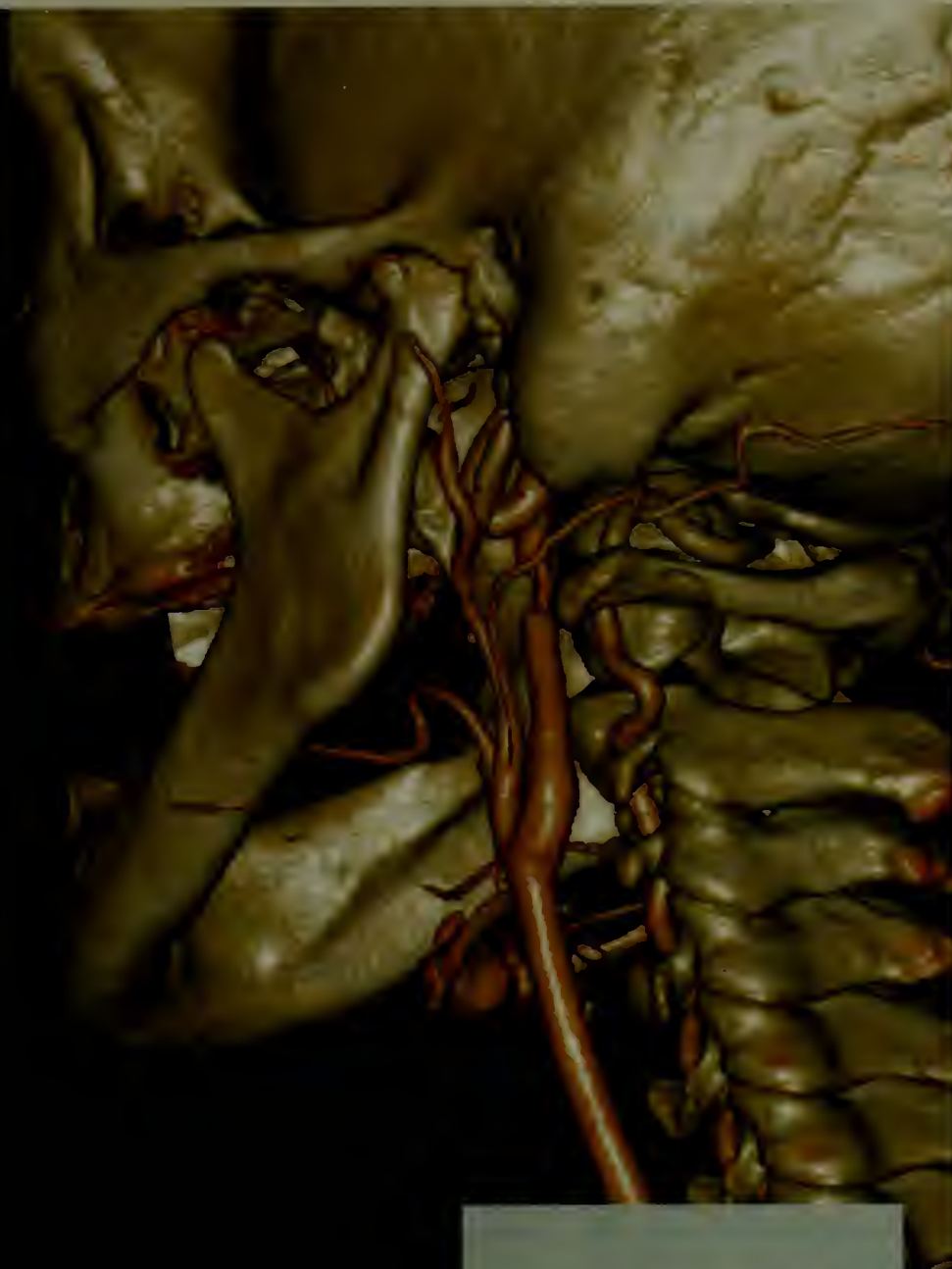
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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO 9-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Apollo Group APOL ⁽⁴⁾	492.8	33	1386.6	35	15.7	-78	193.5	2	3.2	19.0	29.0	82	0.77
Avery Dennison AVY	1336.2	11	3906.9	11	75.0	16	196.1	-3	5.6	5.4	16.6	26	2.35
Banta BN	380.3	8	1121.0	9	19.1	20	48.4	40	5.0	4.5	11.9	18	2.36
Block (H&R) HRB ⁽⁸⁾	482.7	-3	3634.0	8	-44.1	NM	638.3	0	NM	2.3	42.8	14	3.62
Brink's BCO	1195.0**	20	3421.0	18	37.7	288	67.5	386	3.2	1.2	13.1	27	1.31
Career Education CECO	438.5	39	1250.7	53	43.0	60	124.4	89	9.8	8.5	18.8	18	1.69
Cendant CD	5363.0	5	14881.0	9	593.0	22	1725.0	47	11.1	9.6	14.1	13	1.66
Cenveo CVO	428.1	4	1261.2	1	2.5	15	-17.3	NM	0.6	0.5	-26.3	NM	-0.30
Cintas CTAS ⁽⁷⁾	746.0	10	2181.1	8	72.7	15	211.9	13	9.7	9.3	14.3	27	1.63
Deluxe DLX	485.0	54	1103.2	17	57.5	-1	151.2	-1	11.9	18.5	NM	11	3.76
Donnelley (R.R.) RRD	1968.5	37	5178.8	73	114.4	98	114.4	38	5.8	5.5	3.9	23	1.42
Dun & Bradstreet DNB	333.2	0	1026.5	5	47.5	65	136.8	35	14.3	8.7	841.2	20	2.84
HNI HNI	573.5	15	1546.1	19	36.7	7	85.0	21	6.4	6.9	16.4	22	1.94
IKON Office Solutions IKN ⁽³⁾	1165.9	-2	3513.3	-1	25.6	-21	63.9	-24	2.2	2.7	5.3	18	0.60
Kelly Services KELYA	1244.9	13	3628.1	15	7.4	390	13.5	309	0.6	0.1	2.4	65	0.43
Manpower MAN	3900.8	22	10857.3	22	83.4	90	176.1	101	2.1	1.4	11.1	19	2.53
Miller (Herman) MLHR ⁽⁷⁾	357.3	10	1040.7	9	14.3	131	41.9	430	4.0	1.9	28.2	35	0.70
Pitney Bowes PBI	1217.5	7	3595.3	7	136.5	15	397.8	13	11.2	10.4	44.5	19	2.31
Republic Services RSG	699.9	8	2020.4	7	62.5	40	180.3	13	8.9	6.9	12.8	21	1.51
Robert Half International RHI	708.0	41	1921.5	32	43.1	789	90.9	NM	6.1	1.0	11.2	50	0.55
School Specialty SCHS ⁽⁸⁾	337.8	11	605.8	8	32.0	18	15.8	15	9.5	8.9	11.0	23	1.83
ServiceMaster SVM	1053.9	3	2899.5	5	68.3	NM	150.5	NM	6.5	NM	20.8	22	0.59
Spherion SFN	507.7	14	1460.9	15	2.4	409	2.4	NM	0.5	0.1	0.2	NM	0.03
Steelcase SCS ⁽¹⁰⁾	651.0	6	1812.1	1	7.3	NM	-13.3	NM	1.1	NM	-1.9	NM	-0.16
United Stationers USTR	1028.8	5	2983.4	3	26.3	13	70.7	24	2.6	2.4	13.0	17	2.72
Volt Information Sciences VOL ⁽²⁾	500.7	21	1390.7	19	9.2	338	12.0	NM	1.8	0.5	7.1	24	1.23
Waste Management WMI	3274.0	9	9308.0	7	302.0	44	662.0	34	9.2	7.0	15.2	19	1.53

18 TRANSPORTATION

INDUSTRY GROUP COMPOSITE	61662.1	12	178650.5	13	1092.8	-28	1556.2	-51	1.8	2.8	4.5	79	0.57
(A) AIR FREIGHT & LOGISTICS													
INDUSTRY COMPOSITE	21747.4	15	63140.6	13	1429.0	40	3964.1	33	6.6	5.4	18.0	28	2.73
CNF CNF	973.6	16	2744.9	15	41.9	13	107.2	28	4.3	4.4	15.1	19	2.32
EGL EAGL	719.5	35	1941.7	27	17.5	215	36.2	144	2.4	1.0	10.9	34	0.94
Expeditors Intl. of Washington EXPD	897.2	26	2382.7	26	43.1	32	112.6	32	4.8	4.6	19.6	40	1.35
FedEx FDX ⁽⁷⁾	6975.0	23	20078.0	18	330.0	158	949.0	71	4.7	2.3	12.4	27	3.42
Hub Group HUBG	362.1	7	1039.4	4	3.6	23	10.3	78	1.0	0.9	6.1	28	1.47
Pacer International PACR	438.2	6	1277.3	5	11.3	131	30.2	52	2.6	1.2	16.8	17	1.09
Robinson (C.H.) Worldwide CHRW	1123.8	22	3147.5	18	37.3	37	98.7	24	3.3	3.0	21.7	37	1.48
Ryder System R	1305.9	9	3787.1	6	54.3	34	153.0	59	4.2	3.4	13.4	18	2.94
United Parcel Service UPS	8952.0	8	26742.0	9	890.0	20	2467.0	21	9.9	8.9	21.9	28	2.92
(B) AIRLINES													
INDUSTRY COMPOSITE	23765.1	7	69024.7	10	-1238.1	NM	-4972.3	NM	NM	NM	NM	NM	-3.67
Alaska Air Group ALK	773.8	10	2070.9	13	79.2	95	34.8	18	10.2	5.8	2.6	41	0.69
America West Holdings AWA	578.6	-2	1760.2	4	-47.1	NM	-40.2	NM	NM	5.6	-29.6	NM	-0.99
AMR AMR	4762.0	3	14104.0	8	-214.0	NM	-374.0	NM	NM	0.0	NM	NM	-3.03
Continental Airlines CAL	2564.0	8	7347.0	11	-16.0	NM	-157.0	NM	NM	5.6	-16.1	NM	-1.71
Delta Air Lines DAL	3871.0	6	11361.0	8	-646.0	NM	-2992.0	NM	NM	NM	NM	NM	-26.75
ExpressJet Holdings XJT	385.7	12	1120.5	15	30.8	11	89.1	11	8.0	8.1	146.3	5	2.15
Northwest Airlines NWAC	3052.0	13	8526.0	14	-38.0	NM	-436.0	NM	NM	1.7	NM	NM	-1.13
Southwest Airlines LUV	1674.0	8	4875.0	10	119.0	12	258.0	-31	7.1	6.8	5.9	41	0.40
UAL UALAQ	4305.0	7	12403.0	11	-274.0	NM	-980.0	NM	NM	NM	NM	NM	-13.10
US Airways Group UAIRQ	1799.0	2	5457.0	7	-232.0	NM	-375.0	NM	NM	NM	NM	NM	-8.70
(C) MARINE													
INDUSTRY COMPOSITE	384.2	21	1105.0	22	24.6	14	80.6	59	6.4	6.8	11.3	16	2.32
Alexander & Baldwin ALEX	384.2**	21	1105.0	22	24.6	14	80.6	59	6.4	6.8	11.3	16	2.32
(D) ROAD & RAIL													
INDUSTRY COMPOSITE	15765.5	18	45380.3	16	877.3	23	2483.7	19	5.6	5.3	7.9	21	1.98
Arkansas Best ABFS	461.9	13	1261.2	9	27.4	61	51.1	63	5.9	4.1	14.8	16	2.58
Burlington Northern Santa Fe BNI	2793.0	17	7968.0	15	2.0	-99	444.0	-19	0.1	8.5	7.4	24	1.80
CSX CSX	1980.0	5	5976.0	2	123.0	NM	272.0	312	6.2	NM	5.8	20	1.83
Dollar Thrifty Automotive Group DTG	421.1	14	1074.8	16	25.0	17	45.7	62	5.9	5.8	6.3	17	1.41
Hunt (J.B.) Transport Services JBHT	718.6	16	2015.3	12	47.9	47	126.5	83	6.7	5.3	18.3	23	1.84
Landstar System LSTR	526.9	30	1430.2	23	21.6	83	47.3	33	4.1	2.9	33.8	34	2.02
Norfolk Southern NSC	1857.0	16	5363.0	12	288.0	110	659.0	84	15.5	8.6	9.2	20	1.79
Overnite OVNT	429.0	12	1226.1	12	22.4	14	46.8	7	5.2	5.1	11.7	19	1.78
Swift Transportation SWFT	727.3	17	2040.7	16	25.7	5	66.7	27	3.5	3.9	11.4	16	1.12
Union Pacific UNP	3076.0	4	8998.0	5	202.0	-33	525.0	-27	6.6	10.1	6.8	20	3.28
USF INC	582.1	0	1810.7	4	12.1	-8	17.2	-33	2.1	2.2	5.2	26	1.30



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Saving time saves lives.

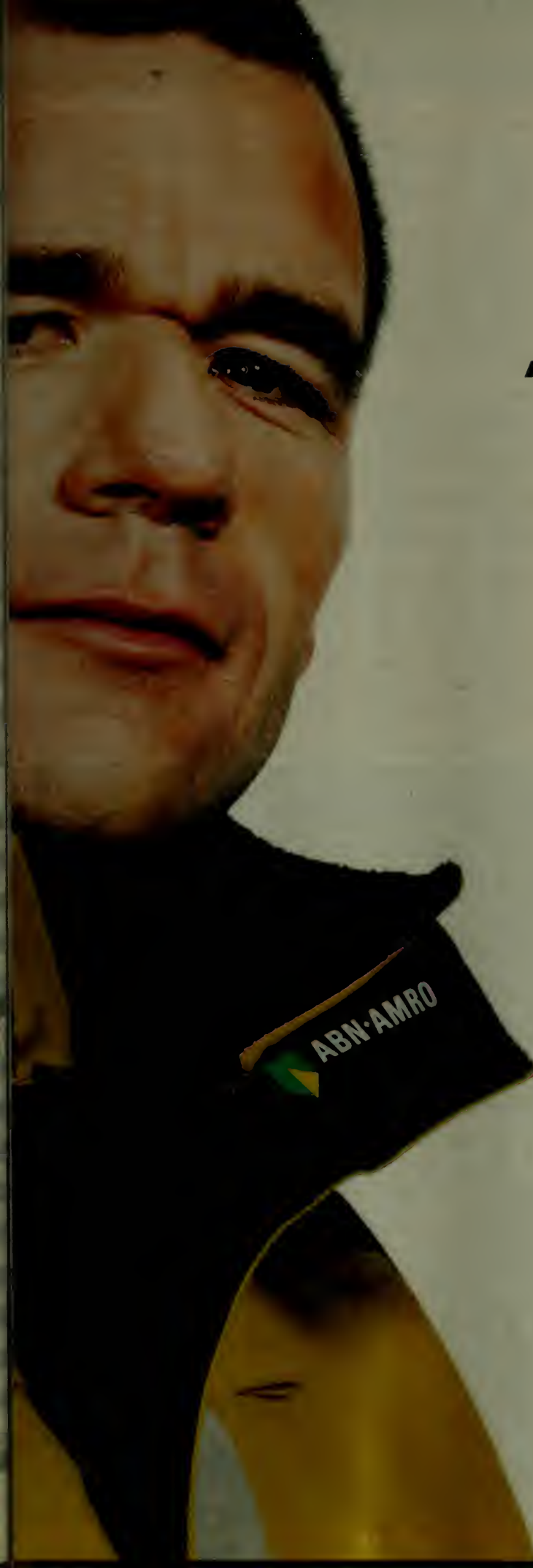
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CORPORATE SCOREBOARD

COMPANY	SALES				PROFITS				MARGINS		RETURN ON CAPITAL EMPLOYED 12 MONTHS ENDING 9-30	PRICE PER SHARE	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Werner Enterprises WERN	425.4	16	1222.8	13	24.3	18	61.5	18	5.7	5.6	11.1	21	1.02
Yellow Roadway YELL	1767.1	129	4993.3	131	55.9	222	121.0	193	3.2	2.3	10.5	20	2.48
INFORMATION TECHNOLOGY													
SECTOR COMPOSITE	191079.6	16	565399.8	17	14027.6	43	44564.4	108	7.3	6.0	13.3	31	0.75
19 SOFTWARE & SERVICES													
INDUSTRY GROUP COMPOSITE	35951.4	15	107540.8	17	5741.8	27	15697.1	27	16.0	14.5	13.4	35	0.81
(A) INTERNET SOFTWARE & SERVICES													
INDUSTRY COMPOSITE	2381.9	74	6499.1	72	383.2	561	808.9	NM	16.1	4.2	8.2	NM	0.40
EarthLink ELNK	344.0	-1	1044.1	-1	37.6	973	75.4	NM	10.9	1.0	16.5	19	0.54
Google GOOG	805.9	105	2157.7	126	52.0	154	195.0	149	6.5	5.2	8.6	NM	0.83
VeriSign VRSN	325.3	21	810.5	1	40.4	NM	71.4	NM	12.4	NM	2.4	NM	0.16
Yahoo! YHOO	906.7	154	2486.8	159	253.3	288	467.0	187	27.9	18.3	8.9	NM	0.38
(B) IT SERVICES													
INDUSTRY COMPOSITE	18032.2	12	53778.5	13	1572.7	28	4542.2	20	8.7	7.7	16.9	22	1.40
Accenture ACN (4)	3806.5	10	11539.1	15	183.0	52	516.5	39	4.8	3.5	46.9	21	1.22
Affiliated Computer Services ACS (6)	1046.2	1	3118.1	3	94.2	8	284.2	14	9.0	8.4	19.8	14	3.92
Anteon International ANT	325.6	17	917.9	20	16.8	54	44.8	48	5.2	3.9	22.6	28	1.37
Automatic Data Processing ADP (6)	1854.7	8	6061.9	9	208.2	7	720.3	-3	11.2	11.3	17.5	28	1.59
BearingPoint BE	840.9	13	2587.4	10	11.9	NM	29.3	NM	1.4	NM	3.4	NA	NA
CACI International CAI (6)	388.7	65	1035.3	51	19.8	52	56.2	49	5.1	5.5	13.5	26	2.36
Convergys CVG	639.9	12	1815.5	7	30.1	-34	91.3	-26	4.7	8.0	11.4	15	0.96
DST Systems DST	599.5	5	1802.3	0	52.5	-1	155.9	-1	8.8	9.3	42.6	14	3.34
First Data FDC	2535.9**	21	7323.4	19	458.9	29	1402.7	41	18.1	16.9	17.4	19	2.20
Flserv FISV	958.1	22	2841.6	29	92.4	15	280.2	20	9.6	10.2	14.4	20	1.84
Iron Mountain IRM	459.3	20	1338.7	22	18.5	25	64.3	14	4.0	3.9	8.0	47	0.71
MPS Group MPS	362.3	32	1006.1	24	9.4	32	24.1	46	2.6	2.6	3.6	40	0.28
Paychex PAYX (7)	345.0	12	1018.0	15	87.7	9	229.6	3	25.4	26.0	24.7	41	0.81
Perot Systems PER	454.3	22	1307.9	22	26.6	69	67.2	89	5.9	4.2	10.2	23	0.70
Sabre Holdings TSG	544.3	3	1635.0	4	67.4	165	169.4	74	12.4	4.8	9.3	20	1.12
SunGard Data Systems SDS	899.3	21	2638.7	23	153.5	66	341.8	32	17.1	12.4	14.6	17	1.54
Titan TTN	526.0	12	1495.0	17	16.6	7	-9.2	NM	3.2	3.3	-2.3	NM	-0.09
Unisys UIS	1445.7	0	4296.7	1	25.2	-55	73.5	-50	1.7	3.9	12.0	19	0.55
(C) SOFTWARE													
INDUSTRY COMPOSITE	15537.3	13	47263.2	15	3785.8	17	10346.0	20	24.4	23.5	12.8	36	0.71
Adobe Systems ADBE (1)	393.7	23	1227.1	31	104.5	62	336.9	84	26.5	20.2	34.3	34	1.70
BMC Software BMC (9)	355.1	6	1081.3	6	12.7	NM	60.3	NM	3.6	NM	1.3	NM	0.06
Computer Associates International CA (9)	855.0	6	2565.0	9	-94.0	NM	-12.0	NM	NM	NM	0.1	NM	0.01
Electronic Arts ERTS (9)	715.7	35	1745.8	30	97.3	27	211.5	103	13.6	14.5	20.8	25	1.94
Microsoft MSFT (6)	9189.0	12	27656.0	15	2901.0	11	6906.0	11	31.6	31.8	11.1	37	0.78
Oracle ORCL (7)	2215.0	7	7800.0	8	509.0	16	2132.0	14	23.0	21.2	34.3	25	0.53
PeopleSoft PSFT	698.8	12	1989.2	26	23.6	NM	58.8	-13	3.4	NM	2.5	NM	0.21
Symantec SYMC (9)	618.3	44	1731.4	43	135.6	63	369.8	76	21.9	19.5	17.5	44	1.36
Veritas Software VRTS	496.7	11	1467.4	18	96.2	29	282.7	73	19.4	16.7	12.3	21	1.07
20 SEMICONDUCTORS & SEMICONDUCTOR EQUIPMENT													
INDUSTRY GROUP COMPOSITE	23537.4	25	67593.2	29	3484.0	65	10015.8	560	14.8	11.2	14.1	25	0.79
Advanced Micro Devices AMD	1239.5	30	3737.7	62	43.8	NM	121.1	NM	3.5	NM	6.4	38	0.45
Agere Systems AGR.A (3)	439.0	-13	1396.0	0	-127.0	NM	-51.0	NM	NM	4.4	-21.4	NM	-0.05
Amkor Technology AMKR	490.8	16	1448.0	26	-22.3	NM	-1.4	NM	NM	3.7	5.4	44	0.12
Analog Devices ADI (2)	717.8	38	2001.7	34	169.1	114	438.5	109	23.6	15.2	13.9	30	1.34
Applied Materials AMAT (2)	2236.2	104	5809.7	78	440.6	NM	896.3	NM	19.7	NM	10.0	31	0.53
Atmel ATML	413.2	23	1241.4	31	-28.1	NM	-5.5	NM	NM	NM	0.5	NM	0.01
Broadcom BRCM	646.5	52	1861.2	65	49.0	NM	152.7	NM	7.6	NM	7.1	59	0.46
Fairchild Semiconductor Intl. FCS	409.5	24	1221.6	18	13.4	NM	43.4	NM	3.3	NM	4.0	37	0.39
Intel INTC	8471.0	8	24611.0	15	1906.0	15	5393.0	56	22.5	21.2	20.1	20	1.15
KLA-Tencor KLAC (6)	518.8	63	1359.0	46	116.4	216	278.8	198	22.4	11.6	12.0	28	1.61
Lam Research LRCX (6)	419.5	128	980.2	76	89.8	NM	161.6	NM	21.4	2.6	18.4	21	1.20
LSI Logic LSI	380.2	-16	1280.5	4	-282.4	NM	-266.1	NM	NM	NM	-14.5	NM	-0.67
Maxim Integrated Products MXIM (6)	435.1	40	1226.1	38	144.5	65	378.4	53	33.2	28.2	21.4	32	1.37
Micron Technology MU (4)	1189.2	34	3297.0	37	93.5	NM	156.1	NM	7.9	NM	2.8	49	0.24
National Semiconductor NSM (7)	548.0	29	1632.8	30	117.7	272	305.0	NM	21.5	7.4	20.3	17	0.96
Novellus Systems NVLS	415.9	88	1017.0	46	64.7	NM	119.2	NM	15.5	NM	7.1	31	0.86
NVIDIA NVDA (11)	456.1	-1	1400.1	8	5.1	-79	50.6	-47	1.1	5.3	5.2	47	0.33
Teradyne TER	457.8	39	1414.9	42	41.1	NM	161.9	NM	9.0	NM	13.3	22	0.75
Texas Instruments TXN	3250.0	28	9427.0	33	563.0	26	1371.0	100	17.3	17.6	14.6	23	1.06
Xilinx LXNX (9)	403.3	28	1230.2	32	86.2	53	312.4	105	21.4	17.9	14.9	28	1.06
21 SEMICONDUCTOR EQUIPMENT													
INDUSTRY GROUP COMPOSITE	131590.8	15	390265.8	16	4801.8	51	18851.5	150	3.6	2.8	12.9	31	0.69



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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS				RETURNS	EFFECTIVE RISK RATING	P/E
	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2ND Q03 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2ND Q03 %	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2ND Q03 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2ND Q03 %	3RD QUARTER 2004 %	9 MONTHS 2004 %					
(A) COMMUNICATIONS EQUIPMENT															
INDUSTRY COMPOSITE	22782.0	25	66894.6	27	333.5	-80	5287.9	41	1.5	9.2	12.3	40	0.42		
Andrew ANDW (3)	487.8	41	1428.0	88	0.7	-87	28.9	139	0.1	1.5	2.1	71	0.20		
Avaya AV (3)	1076.0	11	3098.0	9	100.0	82	261.0	NM	9.3	5.7	36.7	24	0.63		
Cisco Systems CSCO (5)	5926.0	26	16944.0	21	1380.0	41	3882.0	31	23.3	20.9	19.2	28	0.70		
Corning GLW†	1006.0**	30	2821.0	24	-2511.0	NM	-2348.0	NM	NM	4.3	-67.8	NM	-1.72		
Harris HRS (6)	669.4	22	2046.2	24	40.1	57	108.6	93	6.0	4.7	10.5	30	2.08		
Juniper Networks JNPR	375.0	118	906.0	83	48.8	577	69.7	185	13.0	4.2	1.5	NM	0.18		
Lucent Technologies LU (3)	2402.0	19	6786.0	6	348.0	252	803.0	NM	14.5	4.9	NM	14	0.25		
Motorola MOT	8624.0	26	25885.0	36	479.0	313	885.0	119	5.6	1.7	9.9	30	0.57		
Qualcomm QCOM (3)	1118.0	28	3675.0	32	387.0	52	1314.0	74	34.6	29.3	17.9	37	1.03		
Scientific-Atlanta SFA (6)	452.7	14	1348.5	14	55.9	31	180.1	54	12.3	10.8	12.4	19	1.49		
UTStarcom UTSI	645.0	10	1956.9	48	5.0	-92	103.6	-24	0.8	10.1	12.4	13	1.30		
(B) COMPUTERS & PERIPHERALS															
INDUSTRY COMPOSITE	69881.3	11	208037.9	11	3660.3	24	11415.1	37	5.2	4.7	15.0	26	1.04		
Apple Computer AAPL (3)	2350.0	37	6273.0	32	106.0	159	213.0	188	4.5	2.4	5.4	77	0.71		
Dell DELL (1)	11706.0	20	34758.0	20	799.0	29	2279.0	25	6.8	6.4	47.6	32	1.14		
Diebold DBD	613.4	8	1663.7	14	48.3	0	121.2	5	7.9	8.5	15.5	21	2.48		
EMC EMC	2028.9	34	5871.7	34	218.0	37	550.6	100	10.7	10.5	6.9	40	0.32		
Gateway GTW	915.1	4	2621.1	4	-56.5	NM	-561.0	NM	NM	NM	NM	NM	-1.93		
Hewlett-Packard HPQ (2)	18889.0	9	58516.0	10	586.0	97	2406.0	43	3.1	1.7	8.4	18	1.06		
International Business Machines IBM	23429.0	9	68832.0	9	1800.0	1	5393.0	10	7.7	8.3	27.3	20	4.70		
Lexmark International LXX	1266.2	9	3769.9	11	156.1	50	413.7	38	12.3	9.0	27.1	20	4.15		
Maxtor MXO	927.2	-13	2765.1	-5	-94.8	NM	-111.7	NM	NM	2.8	-11.9	NM	-0.31		
NCR NCR	1454.0	7	4196.0	6	44.0	144	161.0	NM	3.0	1.3	12.6	23	2.52		
Network Appliance NTAP (8)	358.4	38	992.7	36	46.9	73	123.5	73	13.1	10.4	11.9	55	0.47		
SanDisk SNDK	408.0	45	1228.2	78	54.1	266	188.3	132	13.3	5.2	16.5	14	1.49		
Seagate Technology STX (6)	1558.0	-10	4282.0	-13	54.0	-73	180.0	-66	3.5	11.4	20.1	17	0.77		
Storage Technology STK	526.5	1	1558.2	2	42.8	38	101.7	31	8.1	6.0	12.6	18	1.56		
Sun Microsystems SUNW (6)	2628.0	4	8389.0	1	-174.0	NM	-151.0	NM	NM	NM	-4.4	NM	-0.09		
Western Digital WDC (6)	823.6	15	2321.3	11	30.4	508	107.9	19	3.7	0.7	34.8	11	0.82		
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS															
INDUSTRY COMPOSITE	35211.6	18	103937.4	20	645.0	NM	1612.4	NM	1.8	NM	6.3	34	0.51		
Agilent Technologies A (2)	1885.0	25	5359.0	22	100.0	NM	275.0	NM	5.3	NM	8.7	42	0.59		
Agilysys AGYS (3)	364.4	25	1122.7	35	3.8	NM	14.0	NM	1.1	NM	7.2	20	0.78		
Amphenol APH	384.1	22	1126.5	26	41.6	48	117.7	66	10.8	9.0	34.9	21	1.68		
Anixter International AXE	849.6	30	2426.9	24	17.2	52	48.0	67	2.0	1.7	8.6	24	1.59		
Arrow Electronics ARW	2668.7	27	8094.4	31	63.4	NM	159.8	NM	2.4	NM	9.2	15	1.62		
Avnet AVT (6)	2600.0	8	7882.6	14	36.3	NM	111.7	NM	1.4	NM	6.0	18	0.99		
AVX AVX (3)	330.0	23	990.8	26	18.6	NM	35.3	NM	5.6	NM	1.9	80	0.15		
Bell Microproducts BELM	728.7	31	2019.4	27	2.8	642	5.5	NM	0.4	0.1	3.9	30	0.29		
Benchmark Electronics BHE	504.8	11	1477.1	9	18.0	39	50.8	21	3.6	2.8	8.9	24	1.52		
Brightpoint CELL	454.1	-14	1359.2	10	5.4	-6	13.7	54	1.2	1.1	14.4	15	1.04		
CDW CDWC	1511.1	24	4230.6	28	65.2	46	178.7	37	4.3	3.6	19.1	24	2.57		
GTSI GTSI	330.6	21	748.3	17	10.5	201	7.5	163	3.2	1.3	8.9	12	0.84		
Ingram Micro IM	6016.4	16	18008.6	14	77.3	-5	140.7	37	1.3	1.6	9.1	15	1.19		
Jabil Circuit JBL (4)	1626.2	25	4743.9	30	44.3	120	124.4	259	2.7	1.5	9.2	31	0.81		
Mettler-Toledo International MTD	342.0	7	1005.2	8	24.6	2	71.7	14	7.2	7.5	15.5	21	2.29		
Molex MOLX (6)	640.2	29	1841.2	30	55.6	74	158.3	169	8.7	6.5	9.6	29	1.04		
PC Connection PCCC	351.3	1	1014.2	6	2.8	29	6.2	21	0.8	0.6	4.3	26	0.28		
Sanmina-SCI SANM (3)	3301.4	21	9233.6	18	7.9	NM	-24.6	NM	0.2	NM	-0.3	NM	-0.02		
ScanSource SCSC (6)	362.7	31	989.4	31	8.9	47	26.1	55	2.5	2.2	16.6	25	2.52		
Soletron SLR (4)	3014.2	23	8941.5	25	-44.5	NM	-199.6	NM	NM	NM	-10.6	NM	-0.29		
Symbol Technologies SBL	442.7	17	1295.1	14	21.1	83	56.7	NM	4.8	3.1	7.2	48	0.31		
SYNNEX SNX (1)	1340.2	29	3835.4	33	11.4	50	31.3	47	0.9	0.7	11.7	15	1.40		
Tech Data TECD (11)	4578.8	10	14319.9	18	30.7	79	104.3	NM	0.7	0.4	7.8	18	2.24		
Vishay Intertechnology VSH	584.3	10	1871.9	17	22.1	226	99.2	501	3.8	1.3	4.0	22	0.61		
(D) OFFICE ELECTRONICS															
INDUSTRY COMPOSITE	3716.0	0	11396.0	0	163.0	39	536.0	288	4.4	3.1	15.0	21	0.77		
Xerox XRX	3716.0	0	11396.0	0	163.0	39	536.0	288	4.4	3.1	15.0	21	0.77		
MATERIALS															
SECTOR COMPOSITE	109481.7	20	316691.3	18	6892.2	NM	17139.7	229	6.3	0.5	12.4	23	1.68		
INDUSTRY GROUP COMPOSITE	109481.7	20	316691.3	18	6892.2	NM	17139.7	229	6.3	0.5	12.4	23	1.68		
(A) CHEMICALS															
INDUSTRY COMPOSITE	40462.7	15	123386.1	14	2259.7	NM	7607.7	142	5.6	NM	16.4	21	1.92		
Air Products & Chemicals APD (1)	1977.5	20	5726.5	18	168.1	28	472.3	74	8.5	8.0	13.6	20	2.64		

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COMPANY	SALES				PROFITS				MARGINS		RETURN ON EQUITY 12 MONTHS ENDING 3-3	PRICE EARNINGS RATIO AS OF 11-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Airgas ARG ⁽⁹⁾	599.8	30	1665.9	22	22.8	19	66.6	19	3.8	4.2	11.6	22	1.16
Albemarle ALB	413.9	50	1062.7	30	0.8	-92	35.2	-39	0.2	3.6	7.8	31	1.23
Cabot CBT ⁽²⁾	496.0	10	1488.0	7	14.0	-46	92.0	119	2.8	5.8	10.5	20	1.79
Crompton CK	639.4	14	1910.5	18	-42.9	NM	19.2	NM	NM	NM	-12.5	NM	-0.34
Cytec Industries CYT	433.5	18	1270.7	14	19.3	-13	80.9	6	4.5	6.0	10.4	22	2.08
Dow Chemical DOW	10072.0**	26	29225.0	20	617.0	86	1771.0	119	6.1	4.2	25.7	17	2.86
DuPont DD	5740.0**	-7	21340.0	4	331.0	NM	1502.0	310	5.8	NM	20.8	21	2.12
Eastman Chemical EMN	1649.0**	14	4922.0	13	38.0	NM	116.0	NM	2.3	NM	12.1	30	1.62
Ecolab ECL	1090.3	11	3112.4	11	94.9	9	239.2	14	8.7	8.9	20.9	30	1.18
Engelhard EC	1002.0	9	3149.8	18	59.1	-1	177.4	3	5.9	6.5	17.8	15	1.91
FMC FMC	497.5	6	1537.5	9	33.3	NM	81.4	303	6.7	NM	14.4	17	2.74
Fuller (H.B.) FUL ⁽¹⁾	349.5	9	1031.2	10	9.5	-23	25.8	2	2.7	3.8	7.4	21	1.36
Georgia Gulf GGC	596.4	71	1615.3	51	33.4	332	81.8	465	5.6	2.2	34.6	20	2.40
Grace (W.R.) GRA	579.9	11	1670.8	14	48.0	NM	85.1	NM	8.3	NM	NM	23	0.54
Great Lakes Chemical GLK	391.9	7	1193.2	9	-1.2	NM	19.4	NM	NM	NM	-2.0	NM	-0.33
International Flavors & Fragrances IFF	506.2	5	1565.4	9	42.3	-17	155.2	15	8.4	10.6	23.0	19	2.03
Lubrizol LZ	922.6	81	2222.8	45	32.2	33	73.6	-8	3.5	4.8	6.1	21	1.62
Lyondell Chemical LYO	1307.0	37	3573.0	25	50.0	NM	38.0	NM	3.8	NM	-3.6	NM	-0.23
Monsanto MON ⁽⁴⁾	1258.0	-3	4429.0	9	-37.0	NM	348.0	211	NM	NM	5.2	42	1.01
Olin OLN	520.1	25	1521.8	27	18.7	212	32.0	NM	3.6	1.4	8.9	43	0.47
PolyOne POL	552.2	12	1645.6	10	11.8	NM	29.4	NM	2.1	NM	-0.1	NM	-0.01
PPG Industries PPG	2409.0	9	7102.0	8	194.0	37	500.0	32	8.1	6.4	19.1	18	3.60
Praxair PX	1674.0	18	4808.0	16	177.0	18	516.0	20	10.6	10.6	19.9	22	2.03
Rohm & Haas ROH	1803.0	13	5436.0	14	137.0	37	369.0	106	7.6	6.3	13.4	20	2.13
RPM International RPM ⁽⁷⁾	661.5	14	1823.2	14	54.5	14	113.5	NM	8.2	8.2	14.6	15	1.27
Scotts SMG ⁽³⁾	376.1**	7	1909.9	9	-1.9	NM	171.2	14	NM	NM	11.5	22	3.02
Sigma-Aldrich SIAL	340.6	8	1057.3	8	56.3	20	178.2	24	16.5	14.9	19.9	18	3.22
Terra Industries TRA	376.1	16	1152.9	17	6.5	NM	42.5	NM	1.7	NM	25.3	7	1.03
Valspar VAL ⁽²⁾	655.6	10	1795.6	10	44.9	12	102.4	16	6.9	6.7	13.0	20	2.41
Westlake Chemical WLK	572.0	60	1422.3	35	28.3	NM	73.4	NM	5.0	NM	14.6	NA	NA
(B) CONSTRUCTION MATERIALS													
INDUSTRY COMPOSITE	3156.8	10	7835.0	8	353.6	21	584.4	70	11.2	10.1	10.9	17	2.91
Lafarge North America LAF	1259.6	8	2758.3	13	165.6	0	196.8	32	13.1	14.3	9.2	14	3.49
Martin Marietta Materials MLM	506.2	1	1323.9	4	53.0	16	90.5	26	10.5	9.1	10.2	20	2.46
Texas Industries TXI ⁽⁷⁾	499.9**	33	1427.8	4	35.9	NM	94.4	NM	7.2	NM	11.0	14	3.71
Vulcan Materials VMC	891.2	7	2325.0	7	99.1	5	202.7	25	11.1	11.3	13.5	20	2.55
(C) CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	15109.0	12	42298.2	10	617.2	348	13070.0	59	4.1	1.0	1.9	NM	0.14
AptarGroup ATR	325.9	16	953.3	14	25.3	32	69.3	16	7.8	6.8	11.1	21	2.40
Ball BLL	1478.7	9	4177.4	10	101.7	48	239.2	37	6.9	5.1	29.6	16	2.59
Bemis BMS	711.9	8	2108.8	7	43.8	26	132.6	22	6.2	5.2	13.8	17	1.59
Crown Holdings CCK	1992.0	8	5451.0	8	58.0	867	78.0	255	2.9	0.3	10.3	91	0.14
Graphic Packaging GPK	617.2	29	1799.4	61	5.5	NM	-6.7	NM	0.9	NM	-4.3	NM	-0.10
Greif GEF ⁽²⁾	584.8	18	1595.9	14	14.9	315	20.0	NM	2.5	0.7	4.2	39	1.13
Owens-Illinois OI	1717.8	31	4484.9	19	65.7	137	190.4	207	3.8	2.1	NM	NM	-6.16
Packaging Corp. of America PKG	498.8	12	1397.4	7	25.7	NM	32.5	NM	5.1	NM	4.1	75	0.30
Pactiv PTV	865.0	9	2498.0	8	56.0	115	108.0	-16	6.5	3.3	18.0	22	1.11
Rock-Tenn RKT ⁽³⁾	417.9	9	1215.2	10	6.6	-32	5.5	-78	1.6	2.5	2.2	59	0.27
Sealed Air SEE	944.2	4	2781.0	7	63.8	-3	185.3	-4	6.8	7.3	18.9	21	2.48
Silgan Holdings SLGN	784.8	3	1854.5	5	38.4	43	67.7	52	4.9	3.5	34.1	14	3.51
Smurfit-Stone Container SSCC	2165.0	11	6145.0	6	31.0	NM	-39.0	NM	1.4	NM	-6.4	NM	-0.56
Sonoco Products SON	811.1	18	2270.4	12	40.9	292	116.2	97	5.0	1.5	12.5	20	1.37
Temple-Inland TIN	1194.0	2	3566.0	2	40.0	NM	108.0	-20	3.4	NM	3.4	48	1.23
(D) METALS & MINING													
INDUSTRY COMPOSITE	29492.6	48	80562.7	42	2403.3	NM	5092.5	NM	8.1	NM	12.8	21	1.82
AK Steel Holding AKS	1337.3	31	3783.5	27	118.6	NM	122.4	NM	8.9	NM	-18.7	NM	-0.53
Alcoa AA	5975.0	13	17718.0	11	298.3	5	1053.0	52	5.0	5.4	11.1	21	1.59
Allegheny Technologies ATI	730.6	51	1954.9	35	8.6	NM	-15.2	NM	1.2	NM	-63.5	NM	-3.07
Arch Coal ACI	527.8	49	1354.0	28	10.8	-2	91.9	NM	2.0	3.1	13.2	18	1.90
Cleveland-Cliffs CLF	348.9	52	886.9	50	82.6	NM	115.4	NM	23.7	NM	35.4	9	9.21
Commercial Metals CMC ⁽⁴⁾	1463.1	82	3938.3	76	47.4	341	119.4	615	3.2	1.3	20.0	9	4.42
Consol Energy CNX	659.9**	20	1985.3	19	-11.6	NM	47.5	490	NM	NM	7.0	NM	0.29
Freeport-McMoRan Copper & Gold FCX	600.6	-5	1447.1	-18	32.3	-59	-25.4	NM	5.4	12.4	-5.4	NM	-0.30
International Steel Group ISG	2608.3	120	6462.4	144	256.4	NM	421.4	NM	9.8	NM	26.7	11	3.58
Massey Energy MEE	430.4**	10	1296.0	12	2.0	NM	12.4	NM	0.5	NM	-0.6	NM	-0.06
Metal Management MTLM ⁽⁹⁾	425.0	85	1160.9	73	34.1	354	70.9	228	8.0	3.3	32.9	6	3.48
Metals USA MUSA	412.6	68	1115.4	56	31.8	NM	84.0	NM	7.7	1.1	30.1	4	4.19

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CORPORATE SCOREBOARD

COMPANY SYMBOL	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO AS OF 11-4	12 MONTHS EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
Newmont Mining NEM	1181.8**	32	3341.7	40	128.7	12	300.0	-16	10.9	12.8	5.9	47	1.03
Nucor NUE	3239.6	102	8287.8	80	415.4	NM	780.1	NM	12.8	1.0	25.7	10	5.03
Oregon Steel Mills OS	348.3	85	882.5	59	50.3	NM	71.9	NM	14.5	NM	10.7	14	1.02
Peabody Energy BTU	923.1**	32	2631.8	27	43.4	102	107.5	457	4.7	3.1	7.9	31	2.11
Phelps Dodge PD	1846.5	79	5094.4	71	292.9	NM	705.2	NM	15.9	NM	18.7	12	7.76
Quanex NX (2)	424.1	71	1089.5	55	21.0	40	39.2	21	5.0	6.1	10.9	17	3.15
Ryerson Tull RT	898.7	63	2398.3	46	15.2	NM	47.2	NM	1.7	NM	9.6	10	1.53
Steel Dynamics STLD	634.7	150	1544.5	118	113.6	NM	212.9	600	17.9	3.6	28.1	9	4.14
United States Steel X	3707.0	48	10079.0	50	354.0	NM	609.0	NM	9.6	NM	31.2	9	4.50
Worthington Industries WOR (7)	769.3	54	2110.3	30	57.9	878	121.8	271	7.5	1.2	19.0	13	1.59
(E) PAPER & FOREST PRODUCTS													
INDUSTRY COMPOSITE	21260.6	6	62609.3	10	1258.4	173	2548.0	359	5.9	2.3	9.4	20	2.10
Bowater BOW	834.0	21	2367.3	19	-18.1	NM	-51.9	NM	NM	NM	-6.9	NM	-1.80
Georgia-Pacific GP	4741.0	-7	15151.0	5	239.0	30	611.0	227	5.0	3.6	10.6	15	2.45
International Paper IP	6578.0	9	18945.0	6	208.0	84	321.0	24	3.2	1.9	5.5	52	0.76
Louisiana-Pacific LPX	740.5	10	2261.1	46	106.3	-4	407.9	236	14.4	16.5	32.7	5	5.24
MeadWestvaco MWV	2148.0	7	6076.0	8	105.0	289	151.0	NM	4.9	1.4	4.2	33	1.00
Potlatch PCH	370.1	20	1029.9	15	24.2	NM	25.0	NM	6.5	NM	7.6	25	2.00
Weyerhaeuser WY	5849.0	13	16779.0	14	594.0	624	1084.0	453	10.2	1.6	13.0	13	5.03
TELECOMMUNICATION SERVICES													
SECTOR COMPOSITE	70561.5	0	208982.3	0	-7995.9	NM	2028.9	-87	NM	5.7	14.7	50	0.44
23 TELECOMMUNICATION SERVICES													
INDUSTRY GROUP COMPOSITE	70561.5	0	208982.3	0	-7995.9	NM	2028.9	-87	NM	5.7	14.7	50	0.44
(A) DIVERSIFIED TELECOMMUNICATION SERVICES													
INDUSTRY COMPOSITE	60875.9	-1	180797.3	-1	-8778.6	NM	-745.4	NM	NM	5.6	17.0	77	0.33
Alltel AT	2103.1	3	6106.3	2	303.7	25	756.1	9	14.4	11.8	14.5	17	3.27
AT&T T	7638.0	-12	23264.0	-12	-7147.0	NM	-6735.0	NM	NM	5.3	NM	NM	-8.01
BellSouth BLS	5095.0	-1	15154.0	-1	852.0	-5	2941.0	11	16.7	17.4	17.1	13	2.03
CenturyTel CTL	603.9	1	1801.1	2	86.2	-5	252.8	-4	14.3	15.2	10.0	14	2.38
Citizens Communications CZN	545.4	-8	1648.0	-13	-11.3	NM	55.4	-48	NM	1.9	5.1	58	0.24
IDT IDT (6)	611.2	26	1703.9	22	-23.3	NM	-81.7	NM	NM	1.7	-9.7	NM	-1.09
MCI MCIP	5076.0	-15	15716.0	-16	-3400.0	NM	-3856.0	NM	NM	NM	407.9	NA	NA
PRIMUS Telecommunications Group PRTL	334.3	2	1014.0	7	16.2	177	-8.8	NM	4.8	1.8	NM	33	0.07
Qwest Communications International Q	3449.0	-3	10372.0	-4	-569.0	NM	-1655.0	NM	NM	NM	NM	NM	-1.14
SBC Communications SBC†	10292.0	1	30500.0	0	1245.0	5	4291.0	-14	12.1	11.7	12.9	17	1.57
Sprint FON	6922.0	3	20498.0	5	-1910.0	NM	-1449.0	NM	NM	NM	-8.4	NM	-0.62
Verizon Communications VZ	18206.0	7	53020.0	5	1779.0	0	4744.0	-4	9.8	10.5	9.4	35	1.16
(B) WIRELESS TELECOMMUNICATION SERVICES													
INDUSTRY COMPOSITE	9685.5	7	28185.0	11	782.6	36	2774.2	111	8.1	6.3	7.7	13	0.76
AT&T Wireless Services AWE	4213.0	-4	12507.0	0	117.0	-25	120.0	-77	2.8	3.6	0.1	NA	0.01
Nextel Communications NXTL	3398.0	18	9790.0	25	588.0	69	2483.0	177	17.3	12.1	35.4	10	2.72
Nextel Partners NXP	357.5	27	996.1	38	35.5	NM	20.8	NM	9.9	NM	-19.9	NM	-0.02
Telephone & Data Systems TDS	968.8	10	2773.9	9	20.8	-52	81.9	139	2.1	4.9	3.4	40	1.85
U.S. Cellular USM	748.2	13	2118.1	11	21.3	-59	68.5	88	2.8	7.8	3.5	42	1.03
UTILITIES													
SECTOR COMPOSITE	87247.5	3	252599.2	4	7072.3	37	19394.5	32	8.1	6.1	10.1	19	1.74
24 UTILITIES													
INDUSTRY GROUP COMPOSITE	87247.5	3	252599.2	4	7072.3	37	19394.5	32	8.1	6.1	10.1	19	1.74
(A) ELECTRIC UTILITIES													
INDUSTRY COMPOSITE	53074.9	0	149917.3	4	5213.5	2	14123.8	32	9.8	9.7	12.2	16	2.40
Allegheny Energy AYE	723.3	20	2067.6	36	51.9	NM	52.2	NM	7.2	NM	2.7	68	0.27
Alliant Energy LNT	730.7	-2	2175.1	1	92.1	4	166.6	37	12.6	11.9	6.6	15	1.78
Ameren AEE	1317.0	-3	3685.0	4	235.0	-15	455.0	-4	17.8	20.5	9.3	18	2.68
American Electric Power AEP	3700.0	-5	11200.0	8	539.0	75	987.0	3	14.6	7.9	10.0	17	2.04
CINergy CIN	1128.6	3	3471.0	5	93.8	-17	257.0	-22	8.3	10.3	9.6	21	1.98
Consolidated Edison ED	2743.0	-2	7601.0	1	249.0	-4	495.0	2	9.1	9.3	7.5	20	2.27
DTE Energy DTE	1594.0	-4	5188.0	-3	93.0	-48	325.0	29	5.8	10.9	10.1	14	3.24
Edison International EIX	3188.0	-7	7840.0	-7	314.0	-27	-37.0	NM	9.8	12.6	4.7	67	0.46
Entergy ETR	2963.6	10	7700.2	9	288.0	-22	772.1	-8	9.7	13.8	8.2	21	3.09
Exelon EXC	3865.0	-13	11137.0	-9	578.0	NM	1481.0	185	15.0	NM	18.4	16	2.63
FirstEnergy FE	3536.3	3	9868.7	4	304.0	90	692.7	121	8.6	4.7	9.7	17	2.50
FPL Group FPL	2983.0	7	7933.0	10	320.0	-5	715.0	-6	10.7	12.2	11.6	15	4.78
Great Plains Energy GXP	714.9	8	1869.8	15	67.9	-19	138.8	-16	9.5	12.7	11.6	16	1.86
Hawaiian Electric Industries HE	506.8	12	1405.7	6	41.2	33	84.4	3	8.1	6.8	10.3	19	1.54
Northeast Utilities NU	1668.0	2	5030.9	10	40.5	-11	133.6	-1	2.4	2.8	5.2	21	0.93
NSTAR NST	781.5	-4	2241.2	1	63.8	-1	152.0	4	8.2	7.8	13.1	15	3.49
OGE Energy OGE	1324.7	25	3521.8	19	94.6	-7	143.4	4	7.1	9.6	11.8	17	1.60

CORPORATE SCOREBOARD

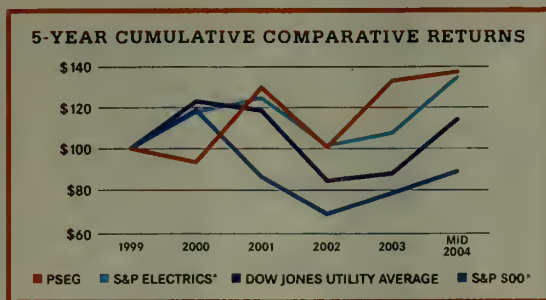
COMPANY	SALES				PROFITS				MARGINS		RETURN ON COMMON EQUITY 12 MONTHS ENDING 9-30	PRICE EARNINGS RATIO AS OF 11-4	12 MONTHS' EARNINGS PER SHARE
	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 \$ MIL.	CHANGE FROM 2003 %	9 MONTHS 2004 \$ MIL.	CHANGE FROM 2003 %	3RD QUARTER 2004 %	3RD QUARTER 2003 %			
PG&E PCG	2623.0	-14	8100.0	2	228.0	-55	3633.0	382	8.7	16.6	45.9	4	8.64
Pinnacle West Capital PNW	886.8	7	2165.0	6	103.9	-4	205.9	14	11.7	13.1	8.7	16	2.76
PPL PPL	1465.0	0	4347.0	1	197.0	14	525.0	6	13.4	11.8	18.7	13	4.16
Progress Energy PGN	2775.0	13	7451.0	11	303.0	-10	564.0	-19	10.9	13.7	9.0	15	2.79
Puget Energy PSD	515.0	5	1774.4	7	11.1	1	70.7	-10	2.2	2.2	6.8	21	1.15
Southern SO	3441.0	4	9182.0	6	645.0	4	1328.0	-2	18.7	18.8	14.7	17	1.96
Teco Energy TE	742.3	-2	2097.6	0	53.2	NM	-0.7	NM	7.2	0.6	1.1	NM	-0.02
Texas Genco Holdings TGN	637.9	-3	1629.7	2	-311.3	NM	-170.3	NM	NM	12.5	-4.0	NM	-1.55
TXU TXU	2743.0	5	7178.0	7	380.0	14	422.0	-20	13.9	12.7	11.6	95	0.65
Wisconsin Energy WEC	696.6	0	2478.9	1	-66.2	NM	37.1	-73	NM	3.1	4.5	37	0.91
WPS Resources WPS	1072.5	8	3491.7	8	37.8	14	94.9	21	3.5	3.4	11.6	15	3.38
Xcel Energy XEL	2008.6	0	6085.9	5	166.2	-10	400.3	7	8.3	9.2	8.3	13	1.33
(B) GAS UTILITIES													
INDUSTRY COMPOSITE	2776.8	4	13260.3	1	-104.7	NM	640.8	-2	NM	1.3	10.4	15	2.04
KeySpan KSE	1050.4	-7	5011.8	-1	-115.8	NM	262.7	5	NM	1.1	11.5	15	2.68
New Jersey Resources NJR (3)	414.4	17	1890.2	1	-5.4	NM	47.2	12	NM	NM	14.9	17	2.55
NiSource NI	979.8	9	4698.0	3	22.6	-8	276.6	-4	2.3	2.7	9.2	14	1.56
Peoples Energy PGL (3)	332.2	16	1660.4	4	-6.1	NM	54.4	-25	NM	0.5	9.8	20	2.29
(C) MULTI-UTILITIES & UNREGULATED POWER													
INDUSTRY COMPOSITE	31395.8	8	89421.6	5	1963.5	NM	4629.8	37	6.3	NM	5.8	34	0.70
AES AES	2423.0	9	6943.0	13	133.0	115	274.0	-17	5.5	2.8	19.4	26	0.43
Calpine CPN	2557.2	-4	6893.7	-1	-40.2	NM	-167.5	NM	NM	8.9	-4.8	NM	-0.54
CMS Energy CMS	1063.0	2	3910.0	-6	51.0	NM	68.0	NM	4.8	NM	-1.2	71	0.14
Constellation Energy Group CEG	3434.5	32	9264.1	29	213.9	9	463.9	27	6.2	7.5	11.9	13	3.35
Dominion Resources D	3292.0	15	10211.0	13	341.0	NM	1052.0	6	10.4	NM	15.3	21	3.07
Duke Energy DUK	5507.0	-1	16466.0	-2	401.0	NM	872.0	9	7.3	0.1	-6.5	NM	-1.07
Dynegy DYN	1650.0	19	4747.0	10	80.0	NM	163.0	NM	4.8	0.3	-6.7	NM	-0.48
MDU Resources Group MDU	804.6	12	1973.4	14	71.7	9	153.9	13	8.9	9.2	12.8	16	1.71
Oneok OKE	1726.8	204	3389.5	58	20.8	354	143.8	-6	1.2	0.8	14.7	14	2.03
Public Service Enterprise Group PEG	2747.0	-1	8258.0	-2	245.0	17	637.0	-8	8.9	7.5	14.3	13	3.37
Questa STR	360.2	32	1293.4	28	36.9	29	155.6	31	10.3	10.5	16.3	20	2.53
Reliant Energy RRI	2808.5	-24	6719.6	-24	120.4	NM	5.1	NM	4.3	NM	-0.5	NM	-0.08
Scana SCG	857.0	14	2832.0	11	56.0	-35	221.0	-11	6.5	11.5	10.4	16	2.29
Sempra Energy SRE	2165.0	5	6521.0	12	233.0	9	588.0	30	10.8	10.4	19.0	10	3.61

Alphabetical List of Companies

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[ANOTHER REASON PSEG HAS WALL STREET'S ATTENTION]



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*S&P 500 Electric Utilities Index.

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York Intl. 16b
YUM! Brands 3
Zale 5d
Zimmer Holdings 14a
Zions Bancorporation 10a



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Web Solutions 2004

Progressive Ideas
and Leading Technologies

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'Intelligent technology' helps retail shoppers find "best buys" online

Last year, nearly 100 million adults made purchases after doing research online. Already in the first six months of 2004, online sales approached \$28 billion in the U.S. alone. This holiday season, if recent trends continue, it will be a joyful retail season for all involved.

Leading retailers of popular consumer electronics gifts and computing products recognize that eager consumers will continue to gobble up merchandise, whether shopping in stores or online. If sales are to increase for high-demand items such as digital cameras, LCD monitors, laptop computers, and MP3 players, consumers

must be able to find them in natural and meaningful ways. After all, if shoppers can't find the products, they can't buy the products.

Finding products online can be an overwhelming experience as compared to walking into a physical store. Virtual aisle markers and shelf labels, known as categories and identifiers, become essential in leading shoppers to the brands and products they want to purchase online. But there is a problem: Retailers and affiliate shopping sites, such as CNET, Froogle and MSN, often think differently about where to place products and how to label them conveniently for online shoppers.

In e-commerce, this becomes a merchandising effort best managed by syndication and synchronization of data among retail channel partners, manufacturers, retailers and affiliates – to ensure that the products, their images, descriptions, pricing and in-stock status are accurately displayed when and where consumers are ready to buy.

The concept of commerce data interchange among manufacturers, retailers and affiliates has been around for a while. Yet, the execution of commerce data syndication based on properly identifying and categorizing products for sale has rapidly become a "must have" technology for the retail industry.

Accurate distribution of this data is igniting intelligent online commerce, and has given retailers a leading edge.

To read the full report, go to
www.technology-reports.com/ci.asp



Founded in 1999 and headquartered near Orlando, FL, Channel Intelligence develops suites of commerce data interchange services including data syndication, which enhance the online and offline sales process among manufacturers, retailers and consumers. Channel Intelligence developed Commerce Data Interchange (CDI), which has become the de facto platform by which retail commerce is conducted online and offline. The company serves more than 100 manufacturers and 250 retailers worldwide. www.channelintelligence.com

Internet Marketing: Performance-Based Keyword Advertising

Internet use is experiencing rapid growth, and advertisers, especially those relying on websites for revenue or to disseminate information about their products and services, are constantly seeking to reach online users. Increasingly, online advertisers are turning to performance-based advertising to fulfill their Internet marketing objectives.

Historically, advertising, including most online advertising, has been impression-based, meaning that advertisers are charged based on the number of viewers, listeners, readers, or users who are potentially exposed to their ad, with no guarantee that the ad was seen, heard, or read. With the inherent

accountability of the Internet, and the decreasing attention paid to banner ads, online advertisers are demanding performance-based advertising alternatives, where advertisers only pay for every visitor who gets to the advertisers' websites, or who registers for or buys the products or services offered.

Internet advertisers can select from a variety of performance-based advertising alternatives, including pay-per-click, banner, e-mail, and pop-up campaigns. However, performance-based, keyword-targeted advertisements have the advantage of getting an advertiser's message in front of prospects whilst the prospects have shown they are interested in what

the advertiser has to offer, either because the prospect has searched for the keyword, or has visited a site related to that keyword. Consequently, advertisers have increased the allocation of their online marketing budgets spent on keyword-targeted advertisements. According to US Bancorp Piper Jaffrey, total spent within the keyword search vertical within the United States will grow to \$4.8 billion by 2006.

Internet users and advertisers alike rely on browsers, applications and websites which provide Web directories, search engines, or contextually relevant listings as an avenue for buyers of certain products and services to locate companies providing those items. These applications grant consumers access to relevant product and services, while offering advertisers exposure to a highly qualified Internet audience.

To read the full report, go to
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GenieKnows.com is a leading developer and provider of performance-based online marketing services. GenieKnows.com's services include the GenieKnows.com Network – a keyword-targeted advertisement service that distributes millions of advertisements throughout the Internet based on a bid-for-position, pay-per-click pricing model – and a Private Label Service using GenieKnows.com's turn-key Pay Per Click operation. 877.644.3643 • www.genieknows.com

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The Bottom Line: Spend Analysis Delivers Significant Savings

Most companies don't have granular visibility to their spending across the entire organization. Dirty data, non-standard items, incorrectly identified company relationships, separate business unit contracts and even naming and part number problems all get in the way. And that means that supply managers and business executives are developing strategies and making decisions based on what they think—not what they know. The Aberdeen Group calculates that businesses lose close to \$60B each year because they can't seem to capture, categorize and understand their spend data. On the other hand, businesses with precise, com-

prehensive spend data available—at the right time—get critical information about their spending patterns, contract compliance, performance ratings, and inventory. The right spend insight identifies chances to save money while building the right foundation for sourcing, planning, budgeting and products.

The most successful spend data management programs rely on several factors, including access to all spend sources, creating shared, consistent classifications, and data cleansing across all suppliers, records, systems, and purchasing users. Once clean, processing, classification and analysis can give an accurate, detailed spend picture. To understand overall spend, compa-

nies need to analyze it often, improving their base data whenever possible, with business intelligence.

Spend analysis solutions extract and clean data from many sources including purchase orders, invoices, P-card statements, accounts payable, enterprise resource management and the general ledger. These solutions accurately classify spend data records on the first pass and provide immediate benefits to companies that choose on-demand spend analysis.

Today, a new breed of on-demand spend analysis solutions deliver accurate spend analysis, cost effectively. They enable companies to analyze corporate spend as often as necessary. The on-demand, pay-as-you-go pricing model relieves companies of the burden and expense associated with traditional spend management software solutions.

To read the full report, go to
www.technology-reports.com/ketera.asp



Ketera Technologies is the leading provider of on-demand procurement solutions, providing companies with the applications and services needed to control and reduce corporate spending at a low cost of ownership. As of fall 2004, Ketera has enabled more than 50 clients with their spend management initiatives and has processed more than \$116B through its spend analysis application. For more information visit www.ketera.com or call 408.572.9500.

Buy Printing Like a Pro!

Creating an email newsletter is one thing. But finding a reliable printer who can produce a printed piece the way you want it, when you want it, and at a price you like is another matter. Your choice of printers is one of the most important decisions you'll make to affect the quality and cost of your marketing materials. The relationship built between print buyer and printer is the key to success. If your printer is not willing to give you the support you need, then find another one!

Ask Careful Questions

When interviewing printers, you will want to

get comfortable with their answers to several questions. How quickly can I get a price for my project? What if my specifications change later? Will you furnish me with free tech support when I am working on my design? Are your turnaround-times guaranteed, or will I be surprised later with delays? Can you supply me with samples of your printing so that I can judge the quality for myself? What technical 'tricks' do I need to know when composing my design? Do you have any free resources available to help me in making my design the best it can be?

Money-saving Tips

Design your own publication. Use a software package with which you are comfortable and make sure your printer will support this package at no charge.

The larger the quantity ordered, the lower the per-piece cost. Set-up costs make it cost-prohibitive to produce less than 250 copies of most print projects. Make sure to order sufficient copies to minimize future set-up costs.

Use the CMYK process whenever possible. The CMYK or "process color" approach to printing allows the printer to create almost any color at dramatically lower prices.

To read the full report, go to
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Email Evolves, Leaving High Costs and Complexity Behind

It's almost incredible. Email, the original "killer app," didn't change for 30 years after its invention in 1971. While other technologies swirled through a storm of evolution over the same three decades, email basically looked and worked the same. Even more amazing, in spite of its developmental inertia, email is now a mission-critical application for most businesses. It's also experiencing a technological evolution: the collaborative power of email is now available on the Web, simplifying IT email operations and lowering costs while retaining email functionality.

It started just a few years ago, when a handful of visionary companies connected the dots between

email, the Web and soaring costs in corporate IT departments. Driven by 1990s globalization, IT managers deployed expensive Microsoft Exchange or Lotus Notes email systems around the world. These complex networks were soon flooded with a steady, substantial increase in message volume (29 percent annually) and message size (10 percent annually), plus an alarming influx of SPAM, security issues and legal compliance requirements (Sarbanes-Oxley). To keep up, corporations were forced to escalate spending on storage and management. Already teetering under the weight and complexity of their email networks, many IT

managers also found themselves captive to rising system upgrade costs. With tension at its peak between trusted yet unbearably expensive existing systems and a desperate call for innovative, affordable solutions, the stage was set for acceptance of flexible, low-cost, Web messaging.

Today, companies are shifting from budget-busting, traditional email systems to lighter-than-air Web communications and gaining a host of new capabilities: affordable email for global extended workforces, wireless email, email-to-SMS text messaging, seamlessly integrated email collaborative tools, business continuity, effective SPAM and virus protection, language translation, email retention and archive compliance. The goes on—and so does the evolution of email.

To read the full report, go to
www.technology-reports.com/mail.asp



Mail2World, Inc. is an early visionary company addressing the need for advanced, cost-effective email services. Founded in 2000, Mail2World designs, delivers and supports a technology-leading platform for Web messaging and collaboration services. Created to handle millions of mailboxes, the company's Pangia Communications Platform™ serves millions of users on 70,000+ domains for a variety of markets, including ISPs, portals, educational institutions, individuals and small, medium, and large businesses. www.mail2world.net • 310.209.0060 x1

Medical Practices Increase Cash Flow With ASP Technology for Claims

The survival of medical practices today depends on how quickly accurate claims are submitted and the rapid turnaround of accounts receivable. Electronic claims submission streamlines the billing process and dramatically reduces the time between submitting the claim and receiving payment.

Application Server Provider (ASP) is a cost-effective alternative for medical practices with a low IT budget. ASP technology offers an affordable and easy-to-use management system that includes filing claims electronically.

True ASP applications can be used by anyone with Internet access. ASP technology eliminates the

need to purchase and manage software installations and costly upgrades. The provider houses the technology and acts as the computer technician, software engineer and network administrator.

Because ease of use and access to patient records are very important to a practice, ASP technology integrates the electronic data exchange between the practice, clearing house and insurance company. The more sophisticated ASP systems also eliminate the need to download or upload reports with claim status reflected in the claims automatically. All account information is real-time and can accommodate multiple authorized users.

Private health care practices with a staff of fewer than 10 people are most challenged by electronic claims submission. These practices also are the most reliant on cash flow. They often are forced to outsource billing management because they are unfamiliar with technology or do not have the staff to handle billing management in-house.

ASP technology allows small practices to increase cash flow through electronic claims submission. Practices can easily handle billing in-house, usually without hiring new employees. An ASP billing management system provides efficient electronic claims submission, reduces turnaround time and increases cash flow. Even more important, when billing management is not a hassle, small practices have more time to focus on patients.

To read the full report, go to
www.technology-reports.com/medtask



Medtask is the first company to provide an entirely web-based practice management system using ASP technology. MedTask includes billing management through electronic claims submission, a pre-check function to verify claim accuracy, accounting, invoicing and tracking features and universal access via the Internet. For further information call Marie Cramer, director of Sales, at 720.344.1110 or visit www.MedTask.com.



CLICKING AWAY

Will Microsoft's set-top system top TiVo?

video recorder (DVR), giving it an advantage over the slapdash TiVo wannabes currently on the market from cable providers. The service offers an electronic programming guide that lets users find shows up to two weeks in advance. Users who opt for the digital recorder can copy shows to a 120-gigabyte hard drive, large enough to store 90 hours of programming. "Finally, this is the real deal, and we can take Microsoft's role seriously in set-top-box software," says senior analyst Greg Ireland of researcher IDC.

Seattle area homes. Analysts say it approaches the elegance of TiVo's pioneering digital

Microsoft Sharpens Up Its Elbows

It's taking on TiVo in TV digital recording and Google in Web searches

MICROSOFT IS ON the move again. As it has in the past, the software giant is trying to elbow aside rivals who have pioneered new markets.

Within a space of three days, Microsoft Corp. announced strategies for taking on two companies so identified with their markets that their names have become synonymous with the services they provide: TiVo in digital-video recording, and Google in Web searching. On Nov. 8, Microsoft announced a deal with Comcast Corp., the nation's top cable provider, to offer new digital cable set-top boxes loaded with Microsoft software. And on Nov. 11, the company was set to launch a test version of its new Web search engine.

Initially, neither push looks like it will add much to Microsoft's growth. Yet both are strategic efforts by Microsoft to stake ground in important growth markets. Microsoft leaders know that the days of consumers shopping and communicating through TVs as well as PCs are nearing. And they're also eager to get a piece of the Web search-engine action—a fast-grow-

ing market with enormous potential.

Of course, Microsoft has been down these paths before—with little to show for its efforts. For a decade, the software giant has tried mightily to wedge its way into the digital-TV market, failing at every turn. Remember WebTV? Or UltimateTV? All told, Microsoft has spent more than \$10 billion since 1994 on TV projects and cable investments. And Microsoft's MSN site has offered search since 1998, but it outsourced the technology to partners such as Yahoo. As a result, its me-too search service is a distant third, handling just 14% of U.S.

Web searches in October, vs. 49% for Google, according to the Web analytics firm WebSideStory.

This time, though, the company is convinced it can make inroads. Take Microsoft's set-top box technology, which Comcast will initially offer to 1.1 million

DIRECT QUESTIONS

MICROSOFT IS ATTEMPTING to do with DVR software what it has done with PC software: create a product that's good enough and cheap enough to lure users away from more expensive, and often more compelling, rivals. Comcast's digital cable customers pay \$10 a month on top of their cable bills for the DVR service. That's \$3 less per month than TiVo, and cable customers don't have to buy a separate box that can cost several hundred dollars as they do with TiVo.

The plan for Web search is similar. Microsoft has invested in technology that it hopes will trump Google. The service, available in 26 markets and 11 languages, offers a handful of features not available at the search leader. Web surfers, for instance, can type direct questions, such as: "What is the capital of Turkey?" and get the answer, "Ankara," from Microsoft's Encarta encyclopedia at the top of their search results.

Yet Microsoft's inroads in DVRs and search may be limited. Comcast is its only big U.S. set-top-box customer so far, and the cable company has agreed to roll out only 5 million boxes with Microsoft's software. With search, Microsoft must convince users that results

from MSN search are more relevant than Google's. That will be no small feat, given Google's strong branding. Still, don't underestimate Microsoft. It has never been known for giving up the fight. ■

—By Jay Greene in Seattle
with bureau reports

ROOM FOR MICROSOFT?



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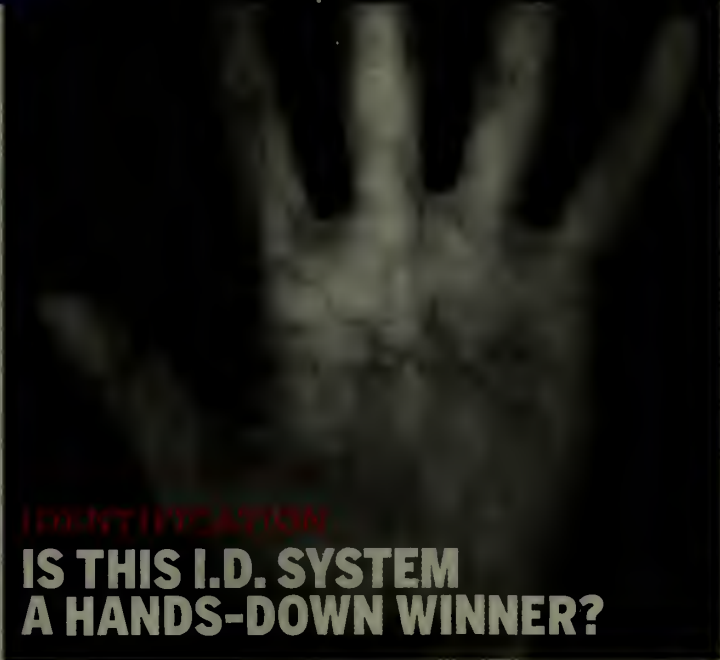
INNOVATIONS

Health-care costs and heart currents

»» Results of a clinical trial reported at the American Heart Assn. Scientific Sessions in New Orleans on Nov. 7 threw some cold water on hopes for disease management. That's a buzzword among medicare experts and many private insurers who believe that having health-care personnel closely monitor patients with chronic diseases such as diabetes can lower costs by keeping the patients out of the hospital. A team of Texas researchers enrolled half of 1,069 patients suffering from heart failure, a progressive disorder, in a disease-management program for 18 months while the other half were treated with standard care. Although the managed patients lived an average of 76 days longer than the control group, it cost just as much to care for them, and there was no drop in hospitalizations.

»» Drugs can fail in their intended purposes and still be beneficial. Procter & Gamble's experimental drug Azimilide failed to correct abnormal heart rhythms in patients with implantable cardioverter defibrillators (ICDs). But in a clinical trial described at the AHA meeting, the drug significantly reduced painful electrical shocks from the devices. It blocks particular currents in the heart that can cause abnormal rhythms. Dr. Paul Dorian of St. Michael's Hospital in Toronto, lead investigator on the trial, says the drug could improve the quality of life for many ICD patients, even if it doesn't prevent the disease from getting worse.

—Catherine Arnst



IDENTIFICATION IS THIS I.D. SYSTEM A HANDS-DOWN WINNER?

SCANS OF fingerprints, irises, and facial features are now integrated in security systems at building entrances, bank ATMs, and elsewhere. But some people find scans intrusive—and they haven't been widely adopted. Fujitsu Laboratories hopes to fare better scanning vein patterns in the palm.

As with fingerprints, each person's palm is unique and changes little over time. An infrared light captures an image when the hand is placed on a device resembling a computer mouse. Authentication soft-

ware then extracts the vein pattern and compares it with patterns already entered in a database to find a match—all in less than a second.

Testing the system on 700 people—from children to seniors—Fujitsu found its scanner had a false rejection rate of 1% and a false acceptance rate of 0.5%. Bank of Tokyo-Mitsubishi, the third largest in Japan, plans to integrate palm-scanning with its cash machines starting this fall, and other banks may follow.

—Amy Tsao

BIOETHICS COMING TO GRIPS WITH STEM CELLS

DESTROYING HUMAN embryos to obtain stem cells may not be palatable to some people even if the embryo consists of just a few hundred cells. Objections might soften, however, if the targeted embryos are not viable to

begin with. Writing in the *Journal of Clinical Investigation*, Columbia University doctors Donald W. Landry and Howard A. Zucker note that our society approves the harvesting of organs and tissues from the living bodies of people who are brain-dead. And there is indeed a comparable status for embryos. Many have defects that keep them from dividing after, say, 24 hours, and thus are “organismically dead,” argue Landry and Zucker. Taking stem cells from such embryos could result in “widespread acceptance of the use of such cells for research and development.”

—John Carey

ENERGY WIND POWER'S IMPRINT ON THE ENVIRONMENT

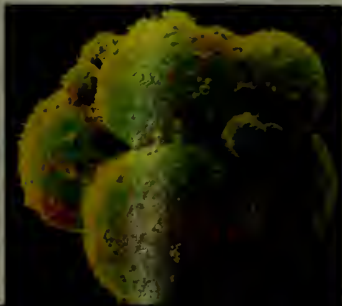
WIND TURBINES ARE a green alternative to fossil fuel-burning power plants, whose carbon dioxide emissions are linked to global warming. But wind farms leave imprints on the environment, too, says University of Calgary professor David Keith. He and his colleagues ran simulations of the impact of windmills generating at least 2 terawatts of energy—about as much electricity as the world uses now. “If you put enough wind turbines all over the planet, it will change the climate,” Keith says. His report appears in the Nov. 16 *Proceedings of the National Academy of Sciences*.

The wind farms would



boost the “surface drag” of the earth, changing circulation patterns around the globe. But “the effects may not necessarily be harmful,” Keith says. Overall global temperature would barely change, but polar regions would be cooler and equatorial regions warmer. That might counteract CO₂-related global warming, which is expected to heat the poles more. Plus, Keith adds, replacing fossil fuel electricity with wind power would have the beneficial effect of reducing CO₂ levels.

—John Carey





Wondering about A Wonder Drug

Statins cut cholesterol, but long-term cognitive and muscle effects are a mystery

GOLD MINE Statins contribute some \$19 billion to drugmakers' coffers

may be more likely to take them

The need for that sort of assessment will only grow more urgent. National health guidelines indicate that some 30 million Americans need cholesterol-lowering therapy. And with studies showing patients can benefit from bringing LDL or "bad" cholesterol, even below what are considered normal levels, some experts worry that statins may be prescribed to more and more people at lower risk of heart attacks. Prescribing such potent lifelong drugs to a healthy population is an uncharted voyage. "Do we know everything about statins?" says Dr. Mary H. Parks, a deputy director at the Food & Drug Administration unit that regulates these drugs. "No, we do not."

HOW THEY WORK

PARKS IS NOT IN the alarmist camp on statins. The problems so far, she says, have been "overwhelmingly small." What's well known is that the drugs work by blocking an enzyme called HMG-CoA reductase, which plays a key role in the

production of cholesterol, especially LDL. When the liver slows production of LDL, the body pulls more of it from the bloodstream to meet its biological needs—leaving less to build up as plaque in the arteries of the heart and other blood vessels. The result is fewer heart attacks in some at-risk patients. "There aren't too many drugs out there

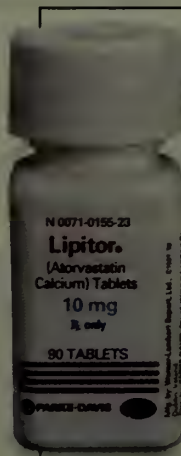
THEY ARE MIRACLE DRUGS of the modern age. Statins, sold under names such as Lipitor and Zocor, rack up sales of \$19 billion annually and are the top-selling medicines in the world.

Why? Study after study shows that for people at high risk for heart disease, they cut the number of fatal heart attacks. Evidence suggests statins may reduce the risk of Alzheimer's disease and slow the course of multiple sclerosis. It's no surprise, then, that many doctors say—only half-jokingly—that statins should be put in the drinking water.

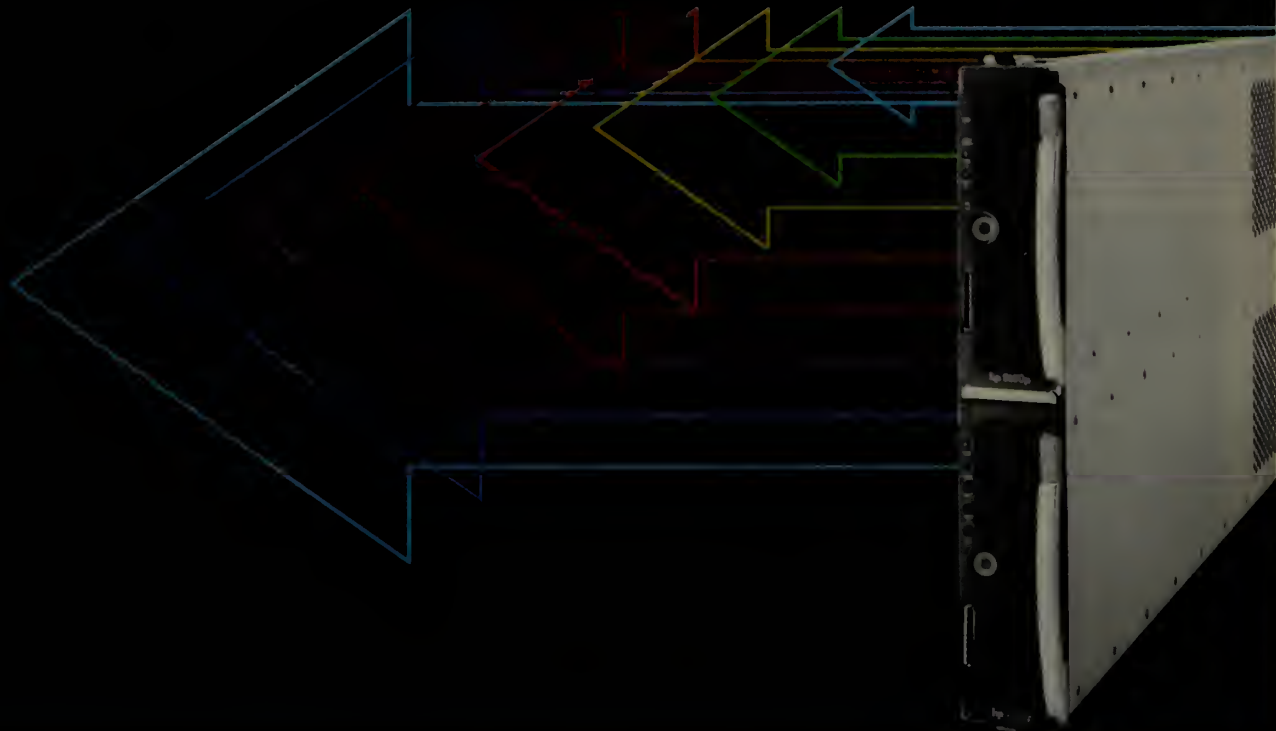
Yet while the benefits of statins are well established, some doctors argue that their side effects have not received adequate scrutiny. A subset of patients reports muscle pain, but it's unclear how widespread these symptoms may be or if they could be a sign of long-term muscle injury. In addition, some scientists are concerned that the drugs could be having a negative impact on cognitive function in certain patients. If that's the case, is the effect permanent? And who is most at

risk? The pharmaceutical industry has spent millions of dollars promoting the merits of statins and searching for new uses. Much less energy has been directed at answering the nagging questions.

At this stage hardly anyone predicts that statins could suffer a fall from grace such as that of Merck & Co.'s painkiller Vioxx, which may have harmed thousands of patients and may engender some of the world's costliest drug-related class actions. But as the Vioxx debacle shows, there are worrisome gaps in the U.S. regulatory system when it comes to spotting side effects of prescription drugs over the long term. Even some proselytizers for statins concede that further studies are needed. And if research helps single out who is at greatest risk of damage from side effects, those most likely to benefit from statins

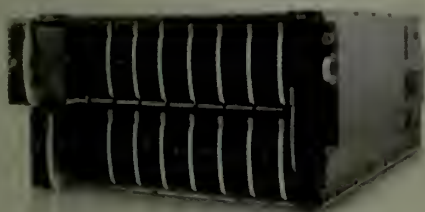


Pfizer's Lipitor, a \$10 billion seller, saves lives—but some scientists assert that statins are linked to lower attention and motor skills



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that have so much clinical data that establish a benefit," says Parks.

Even in the case of known side effects, many outside experts contend that the story is reassuring. Some patients have suffered a rare but sometimes deadly side effect called rhabdomyolysis, in which muscle in the body is broken down. Others suffer less serious muscle aches and weakness. But in total, most statin trials have shown that muscle problems have occurred in fewer than 1% of patients, says Dr. Gary Palmer, vice-president for cardiovascular medicine at Pfizer. Cleveland Clinic cardiologist Steven E. Nissen says the side effects of statins "are rarely life-threatening and relatively manageable."

Nonetheless, troubling uncertainties remain. Take the issue of muscle pains. In clinical trials they seemed to be rare. But physicians such as Dr. James K. Liao, director of vascular medicine research at Brigham & Women's Hospital in Boston and a big supporter of statins, believes muscle pains are much more common, occurring in 15% to 20% of his patients. Doctors often rely on a blood test for an enzyme called creatine kinase (CK) to de-

termine if patients are suffering from statin-related muscle pain. If the CK level is elevated, physicians may change the statin dose or try a different drug. If it's normal, some doctors may assume the muscle pains are not caused by the drug and won't alter the medication.

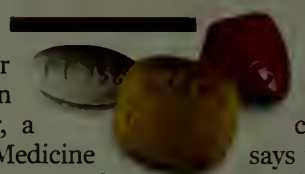
Problem is, some research shows patients can have normal CK levels and still suffer muscle damage. In addition, in 2002, Dr. Helmut Sinzinger, a professor in the Nuclear Medicine Dept. at the University of Vienna, published a paper showing that in 111 patients taking a variety of statins who did not have elevated enzyme levels or suffer any muscle pain, almost 10% did show a rise in a marker in the blood for possible muscle injury. He says that means some patients could be suffering subtle and undetected muscle injury. One theory: Statins may deplete an antioxidant called coenzyme Q10, used by mitochondria, the cells' energy factories. Merck says it did animal studies on this issue and found no link between COQ10 levels and muscle disorders.

While statin makers concede they don't know exactly what leads to muscle woes, Pfizer's Palmer says there's no evidence the drugs cause undetected, long-term muscle damage.

If there are still unknowns about how statins interact with muscle tissue, there are even more questions about how the drugs affect the brain. Epidemiological studies show a link between high cholesterol and a raised risk of Alzheimer's. And Pfizer, after getting positive results from a small study looking at whether its best-selling Lipitor might slow the progression of Alzheimer's, has embarked on a larger, 600-patient trial.

In a seeming paradox, though, statins may also have negative effects on the brain. Dr. Matthew F. Muldoon, associate professor of medicine at Uni-

Links between muscle problems and statins must be clarified



versity of Pittsburgh School of Medicine, published a study in 2000 looking at the effect of Merck's statin Mevacor on cognitive function. He compared the performance of 209 patients before getting any medication and six months after taking either Mevacor or a sugar pill. The results: Statin users did worse on tests of attention and psychomotor speed. Muldoon says this may be a temporary impact that dissipates as the body adjusts to the drug. But it's also possible that statin users suffer longer-term negative cognitive impact.

FAMILY OBSERVATIONS

DR. BEATRICE A. GOLOMB, a researcher at University of California at San Diego, hopes to answer some of those questions. Funded by the National Institutes of Health, she is leading a study looking at the effects of statins on the central nervous system. The 1,000-patient trial will study patients receiving Merck's Zocor, Bristol-Myers Squibb's Pravachol, or a placebo for six months and measure any positive or negative changes in cognition, irritability, aggression, and serotonin levels. Golomb says she has been in touch with many patients and families reporting problems with statins ranging from memory lapses to changes in personality.

Pfizer, Merck, Bristol-Myers, and AstraZeneca, maker of Crestor, say no cognition issues surfaced in clinical trials of their statins, with no sign of a problem among millions of patients filling prescriptions for them. Dr. Yale Mitchel, executive director for clinical research at Merck, says it repeated Muldoon's experiments and didn't get the worrisome results. Statin supporters dismiss the questions as needless scaremongering at a time when many people at high risk for heart disease go untreated.

Without more studies, though, manufacturers will have a hard time putting the concerns to rest. "The enzyme these drugs block is critical for lots of activities in the body," says Dr. James M. Wright, professor of medicine at the University of British Columbia. "So to think that it is going to be all for the good is very naïve." Given the swelling ranks of people taking statins, drug-makers would be wise to investigate their risks as closely as they do their benefits. ■

—By Amy Barrett in Philadelphia and John Carey in Washington

Statins Come with Benefits and Risks

The drugs block an enzyme in the liver that is key to producing bad cholesterol (LDL), resulting in less buildup of arterial plaque. But some doctors worry about side effects:



THEY SAVE HEART PATIENTS' LIVES...

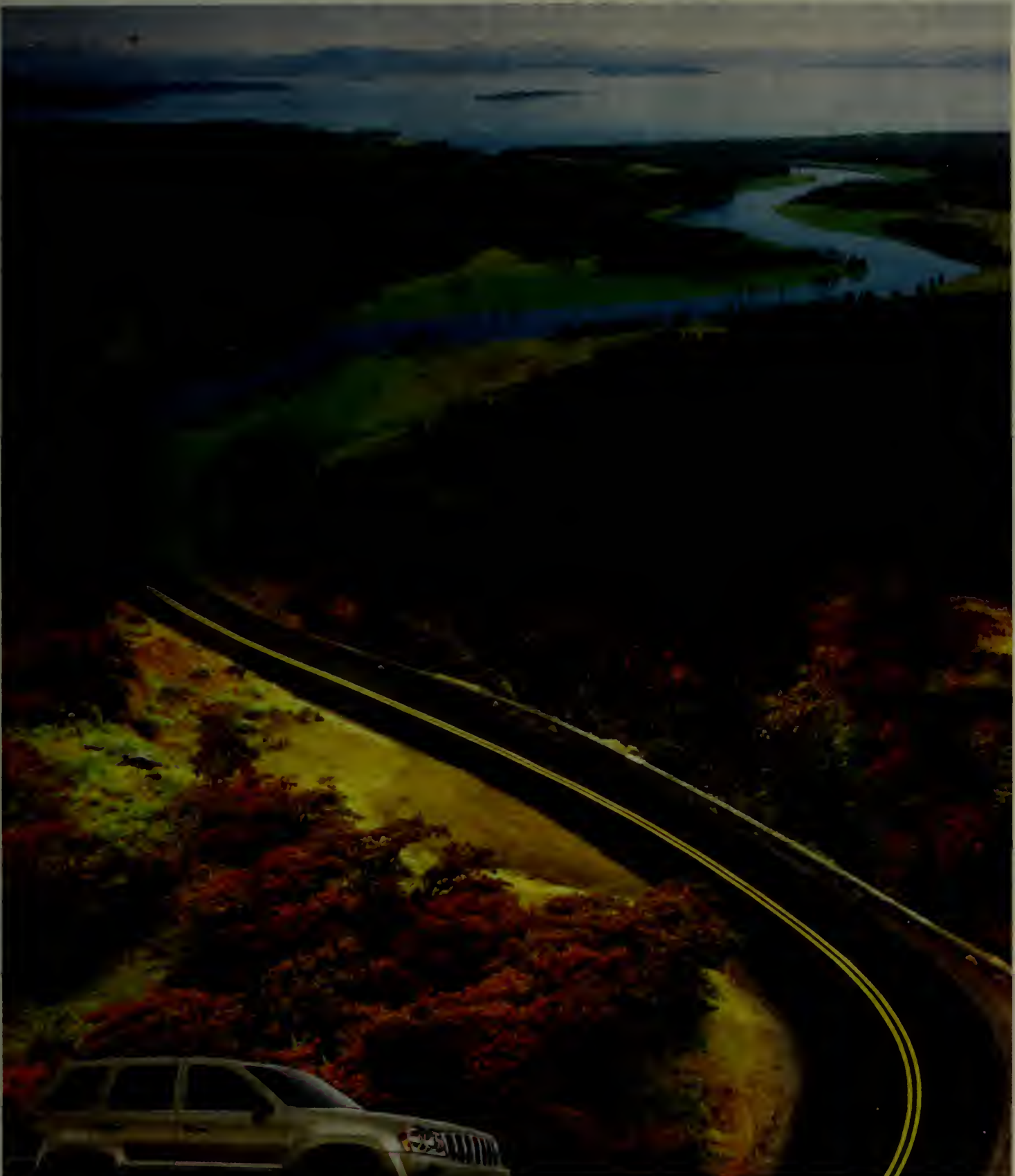
Clinical trials of thousands of subjects show that the drugs reduce death rates in people with heart disease. A landmark Scandinavian study showed that Merck's Zocor cut the risk of coronary mortality by 42%.

...AND MAY HELP OTHERS...

Pfizer is doing a 600-patient trial of Lipitor in Alzheimer's disease after half of the subjects in a 46-patient study improved or stabilized within a year. Statins may also be useful in treating breast cancer and multiple sclerosis at low doses.

...BUT THEY POSE RISKS FOR SOME

Over 15% of patients may suffer muscle pains or weakness. University of California at San Diego is running a 1,000-patient study looking at cognitive performance in patients taking Zocor or Pravachol.



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Easy Broadband— And Smarter Power

Web access from wall outlets is on the way, and utilities see even more on the horizon

ONE DAY SOON, getting a broadband connection at home could be as easy as plugging a cord into an electrical outlet in the wall. The same power lines that deliver electricity to light rooms and run refrigerators will transport messages, music, and video across cyberspace. To link up computers, music players, and TV set top boxes in a home network, people will no longer have to mess with a tangle of wires or Wi-Fi settings. Over the powerlines, they'll have the convenience of plug-and-play—something that still isn't readily available from telephone or cable companies.

And yet, this is not the main reason many U.S. power companies are exploring so-called broadband over powerline (BPL). Consolidated Edison, Hawaiian Electric Co., Southern Co., and others are now eagerly studying BPL's potential to help manage their core business of sup-

plying power. Taking advantage of the technology's fast two-way communications paths, Hawaiian Electric, for example, is testing whether it can get a better read on how customers use appliances. During periods of peak demand, the utility could offer incentives to families to ratchet back on air conditioning. All of this gives them a greater return on their investment in BPL. "The industry has proven the technology, but not the business case," says Clark W. Gellings, a vice-president at the Electric Power Research Institute (EPRI). "If you could use the same asset to deliver home-entertainment and appliance monitoring to consumers, that's phenomenal."

Broadband via electrical wires is certainly a tantalizing idea since nearly every home in the U.S. is served by power lines.

What's more, most residences are threaded with electrical wires terminating in multiple outlets in almost every room. So homeowners can get a high-speed Net connection—up to 3 megabits per second—just by plugging a special modem into any outlet. That matches cable modem speeds and outpaces most DSL offerings.

NEW SERVICES

THE PRINCIPLE BEHIND BPL is simple: Because electricity courses over just the low-frequency portions of power lines, there's room for data to stream over higher frequencies. For years, utilities have sent basic network-maintenance data across their lines at relatively low data rates. Now, by installing more sophisticated computer chips into the network, they can send and receive fast data streams for more high-bandwidth applications, such as real-time, always-on meter reading. (Say good-bye to the friendly meter reader.) And for the first time they can offer new customer services, such as voice-over-Internet or even video on demand.

That, however, will require significant upgrades of utility substations and power lines. And nobody knows exactly how big an investment will be necessary. First, power companies have to mount boxes on certain utility poles to deliver data signals. Early estimates of installation costs range from \$50 to \$150

per home passed, plus \$30 to \$200 more for modems in each home, according to a study by EPRI and its consulting arm, Princeton. Internet service provider EarthLink Inc., which is testing BPL schemes with Con Edison, says that to make money from

**One goal:
Higher peak
vs. off-peak
rates for
electricity**

Untapped Treasure Many utilities see broadband over power line (BPL) as a way to deliver Internet access to consumers and manage the electrical network more efficiently

➤ A Net service provider sends data through power lines over high-frequency portions **1** left unused by electrical current.

➤ In one approach, a Wi-Fi antenna **2** beams data from a specialized BPL box **3** to the home.

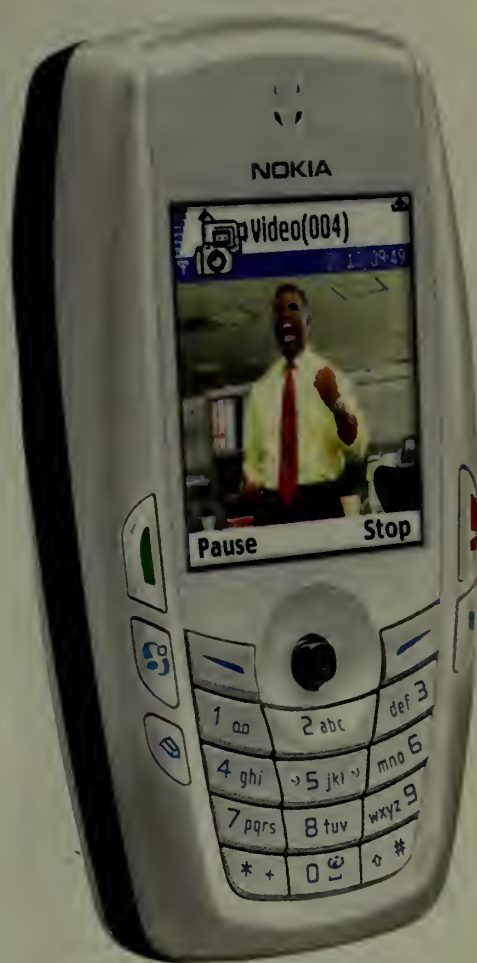
➤ In the home, you can receive a wireless signal or, in some cases, just plug your computer into any wall socket **4**.





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selling broadband access at \$20 to \$30 a month, a utility may have to get installation costs down to \$20 per home passed and less than \$100 per modem.

Given the challenges, utilities will welcome any cost savings from improved energy management. By injecting intelligence into the farthest reaches of the power system, utilities can monitor their networks in ways never before possible. Currently, for example, power companies don't know about local outages until customers report them. With BPL systems watching the flow of data to individual homes, they can pinpoint the neighborhoods without light. While testing residential broadband service in Briarcliff Manor, N.Y. this summer, Con Edison discovered that BPL could help

Con Edison says it sees needed repairs earlier

detect impending faults. A residential customer noticed that his Web service was slowing down. Con Edison crews traced the problem to a cracked insulator on a pole next to his house. Now the company is modeling

normal circuit conditions, then looking at even slight deviations to spot budding problems on its systems. That's a far cry from periodic street maintenance checks, which Con Edison and others mainly rely on today.

In an era of increasing power usage by computers and other digital devices, many utilities are hoping BPL will bring them closer to an elusive goal: demand management. To encourage conservation, power companies would like to charge customers more during peak demand and less at other times. To bill accordingly, they need to measure how much power a home consumes every minute of the day. BPL could help by taking constant measurements. Some experts argue that existing approaches, using two-way pagers, are good enough and that new wireless options are cheaper. But BPL proponents say their wires are faster and more reliable.

Today the very idea of a smart electrical network is in its infancy. But demand for cheap Web access is mounting and so is the need for better power management. To satisfy both ends, utilities could embrace broadband and bring the electrical system into the Internet Age. ■

—By Catherine Yang in Washington

The Trade Gap: How Long Can It Go On?

Some economists see it as sustainable, but most believe the U.S. spree must soon end

THE RAPID GROWTH OF the U.S. trade deficit has sparked vociferous debate—and fresh research—among international economists. The majority of the profession argues that the trade deficit is unsustainable in the long run because it's piling big foreign debts on the next generation—and unsustainable in the short term because it threatens to trigger a financial or political crisis.

On the other hand, it's also possible to believe that the U.S. could run a trade deficit indefinitely without creating big problems. Some economists even argue that U.S. trade deficits, by lubricating global growth, actually have the support of important global players. Here's a quick guide to the issues:

How big is the trade deficit?

Huge. On Nov. 10, the Commerce Dept. reported the September deficit in goods-and-services trade was nearly \$52 billion, the third-biggest ever after

June and August. The deficit in the current account—which covers trade in goods and services as well as investment income and unilateral transfers—zoomed to a record 5.7% of gross domestic product in the second quarter. That towers above a previous high of 3.5% in 1986, when the yawning trade deficit stirred calls for protection against Japanese and European imports.

How is the deficit being financed?

The U.S. is borrowing from abroad and attracting foreign investments into assets such as stocks, corporate bonds, and Treasury securities. But much of the rising flow of money from overseas is coming from foreign central banks, especially Japan's and China's. They favor a strong dollar to keep Americans buying exports. Asian central banks added \$160 billion of U.S. securities in the first half of 2004. If they change policies, it would be far harder for the U.S. to finance its deficit.

What are the arguments that the U.S. can keep running big trade deficits?

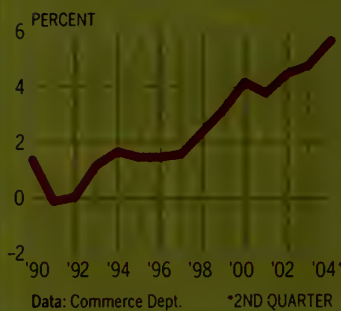
One idea is that the U.S. can easily afford to keep paying for imports with American assets like stocks and bonds because U.S. wealth is growing faster than it's being sold off. From 2000 to the second quarter of 2004, according to Federal Reserve data, the net worth of the U.S. household sector grew by \$3.9 trillion. Household net worth still rose even assum-

ing that Americans are responsible for the soaring debt of the federal government. From 2000 to the second quarter of 2004, the gross federal debt went up by roughly \$1.6 trillion. Taking this debt into account means that Americans are \$2.4 trillion richer than in 2000 despite the big trade deficits.

Isn't the deficit unsustainable because

THE GROWING TRADE DEFICIT

Current account deficit as a percentage of gross domestic product





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the U.S. has to pay lots of interest on its foreign debt?

You would think so. But the U.S. still receives slightly more income on its investments abroad than foreigners do on their larger investments in the U.S. In the second quarter the investment income surplus was \$4 billion, better than one might expect.

Still, doesn't everyone agree that the trade deficit should shrink?

No—some argue that U.S. deficits serve vital interests. American factory workers suffer, but consumers and the government get to spend more than they earn. And nations such as Japan and China benefit from having the U.S. run trade deficits because they rely on exports to the U.S. for growth. Economist Michael P. Dooley of the University of California at Santa Cruz argues that China's biggest problem is the number of unemployed Chinese who need to be given paying work. The best way for China to deal with that problem is by keeping its trade surplus with the U.S. large.

Foreign nations with high savings rates also get a chance to invest surplus capital in the U.S., which is still perceived as having a bright future because of high productivity growth and an unrivaled system for efficiently allocating capital. Federal Reserve Chairman Alan Greenspan argues that the pool of international capital available for investment in promising places like the U.S. is deeper than ever.

Isn't it risky for foreigners to invest so much in the U.S.?

Actually, it can be just the opposite. China, for example, is faster-growing but riskier than the U.S. because of the weak Chinese financial system and the possibility of political turmoil. So finance theory says that the Chinese have a strong interest in diversifying out of their home country into safer, more liq-



T-BILL BOUND!
A Chinese teller tallies

Can Huge Trade Deficits Continue?

Here's how the debate over America's current-account imbalance breaks down

YES

- America's net wealth has continued to grow in recent years, despite the increase of debt to foreigners.

- What matters is the cost of servicing debt—and America's payments on its debt are fully offset by income from U.S. investments abroad.

- Nations such as Japan and China benefit from having the U.S. run trade deficits because they depend on exports to the U.S. for growth.

Data: BusinessWeek

NO

- The debt that the U.S. is accumulating through trade deficits is mostly financing consumption, rather than increasing productive capacity.

- Private investors are growing leery of lending money to the U.S. Foreign central banks, underwriting the deficits, are exposed to huge losses if the dollar falls.

- The enormous need for foreign capital has left the U.S. vulnerable to a run on the dollar, which could send interest rates soaring and trigger a recession.

uid investments such as U.S. Treasuries.

Why do most economists worry about the trade deficit?

Because, they argue, Americans are living beyond their means. They say a trade deficit and inflow of foreign capital can be healthy if the U.S. is investing in projects that generate future wealth. But in recent years, investment has been weak. Imported capital has primarily allowed U.S. consumers to go on a spending binge. In the third quarter, personal saving was just 0.4% of after-tax income, the lowest ratio since at least World War II. As for the rise in Americans' wealth, some say it's largely the result of a bubble in the housing market.

Are there signs that the financial markets are getting worried?

Yes. The clearest indication is downward pressure on the dollar, which in recent days has dropped to a new low against the euro. Against a Federal Reserve trade-weighted index of the currencies of major trading partners, adjusted for inflation, it has fallen 24% from its most recent peak three years ago.

If the dollar keeps falling, will this solve the trade deficit problem?

In the ideal scenario, the weaker dollar would raise the price of imports and make American exports more competitive, especially if China lets its currency rise against the dollar. Over time, Americans would curb consumption and increase savings and investment. Other countries would gradually wean themselves off reliance on exports to the U.S. That's pretty much what happened when the dollar fell 40% against major currencies between early 1985 and late 1990. The current account went from a deficit equaling 3.5% of GDP in 1986 to a small surplus in the first two quarters of 1991.

But the transition might not be gradual?

Right. Some analysts worry that the imbalances are so great that any small even could trigger an avalanche. If there's a panicky run on the dollar, the Federal Reserve might have to jack up interest rates to attract foreign capital. And import prices would leap, threatening stagflation. A slowdown in demand from the U.S. would chill the world economy. While the dollar's 1980s fall was mostly uneventful, some historians say dollar jitters contributed to the stock market crash of Oct. 19, 1987—the biggest one-day percentage decline ever.

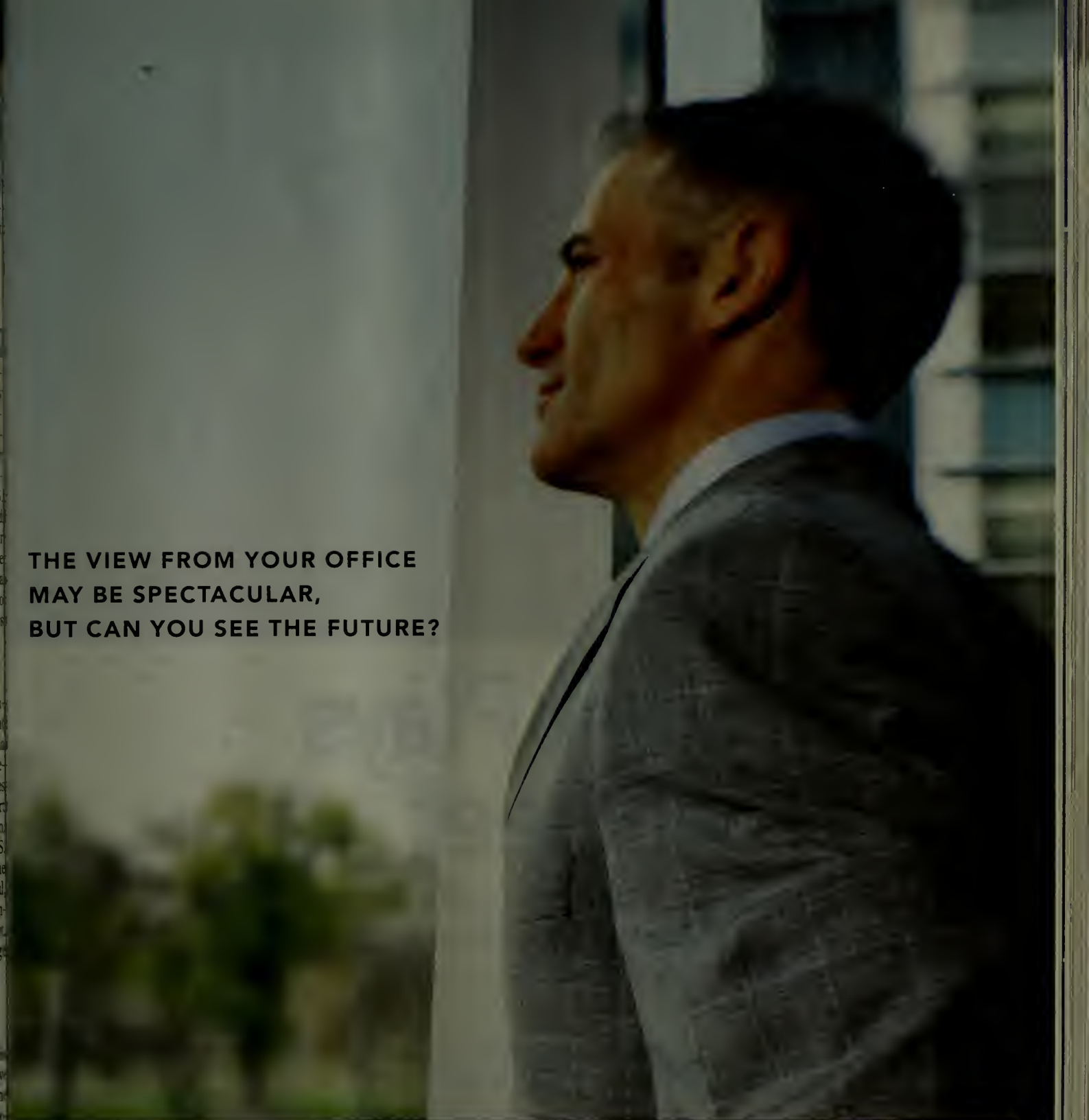
What would reduce the probability of a deficit-induced crisis?

A key element, many economists say, is for Americans to spend less and save more. That would include reducing the government budget deficit. Also, economists Maurice Obstfeld of the University of California at Berkeley and Kenneth S. Rogoff of Harvard University say the U.S. must increase the productivity of its traded-goods sector even more in order to export more and compete with imports.

What's the bottom line for the deficit?

It's hard to say because this experiment has never been conducted before. What happens when the world's sole super power becomes history's biggest debtor? No one's really sure. ■

—By Peter Coy in New York



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BUT CAN YOU SEE THE FUTURE?

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Real Power Plays On Wall Street

To compensate for lackluster growth, financial firms are buying up plants from a cash-strapped power industry

NESTLED ALONG A HIGHWAY in Linden, N.J., a nondescript power plant sends hundreds of megawatts of electricity to New York City daily. It's a mundane task, but someone has to light and heat the city's skyscrapers. What's surprising is that the someone at this complex is one of Wall Street's most prestigious investment banks—Goldman, Sachs & Co.

Goldman has been on a power plant shopping spree. In a little over 12 months, it has picked up 30 of them stretching from North Carolina to Minnesota at a total cost of \$4 billion, including debt. Goldman's reasoning is

simple: The knowledge of energy prices gleaned from its plants gives it a big advantage in cashing in on rising prices and running one of the world's busiest power-trading desks.

These days, bankers and traders are posing as power guys. Saddled with lackluster growth in their other businesses, many financial firms are doing the same as Goldman. Investment banks, buyout firms, hedge funds, and even giants such as American International Group Inc. are scouring the energy landscape for potential earnings gushers in everything from oil and gas to electricity futures. "We now have petroleum and pipeline engineers on retainer," says Joe Colonna, a partner at pri-

vate equity firm Hicks, Muse, Tate & Furst Inc. in Dallas. That's a reversal from the time when executives at Enron Corp. and other power companies scrambled to make big bucks by masquerading as moneymen in the go-go '90s. Then, they dreamt up new ways to trade everything from electricity to bandwidth to weather-related hedges.

What's attracting buyout firms and hedge funds to energy are the potential gobs of money to be made from buying power plants at dirt-cheap prices. In May, MatlinPatterson bought for \$475 million eight state-of-the-art power plants from Duke Energy Corp. that were originally valued on the company books at \$2.6 billion. "Our cost basis is

substantially lower," says Mark Patterson, a founding partner of the private equity firm MatlinPatterson Global Advisors LLC. In addition, there's a chance that some day private equity firms will be able to sell the plants back to corporate buyers at a profit.

SWAP AROUND THE CLOCK

FOR INVESTMENT BANKS, there's the added benefit of tapping markets that are an arbitrager's mecca. Swapping contracts for natural gas, coal, and other forms of power, Goldman's traders operate around the clock, just as its power plants now do. "Understanding the physical infrastructure makes it possible for us to immediately analyze the market and more effectively deploy our [trading] capital," says Richard Ruzika, head of global commodities. It's a heavily regulated business that the Federal Energy Regulatory Commission (FERC) has tried to make more transparent. Owners of power plants and transmission facilities are required to make public most information about the energy they make or deliver and the prices they charge.

Widely fluctuating demand for electricity throughout the day and inefficient distribution offer huge opportunities for trading profits. Dominant players such as Goldman and Morgan Stanley do not break out their energy trading results. But Sanford C. Bernstein & Co. estimates that Goldman and Morgan Stanley each collect about \$1 billion annually in revenues from their commodities-trading operation, much of which is energy-related. It expects these businesses to grow by at least 15% a year and bring in as much as \$2 billion in revenue for each firm by 2007.

Wall Street is transmuting electrons into big money. In September, Merrill Lynch & Co. bought the energy-trading businesses of Entergy-Koch LP for \$800 million. Newly formed private equity firm Diamond Castle says it wants to invest in energy-related businesses. And after it announced that it had bought a natural-gas company for \$405 million in November, Hicks Muse got about 50 phone calls from financial firms, including a dozen hedge funds, that wanted in on the deal, too. The firm turned them all down. Adding it up, over the past 20 months financial firms have announced or closed deals for power plants worth nearly \$15 billion, according to estimates by Platts *Global Power Report*.

The torrent of money from Wall Street is manna for a cash-strapped power industry that has been in chaos since Enron filed for bankruptcy in 2001. Finan-

cial firms have their pick of assets largely because most potential corporate buyers are still struggling. "We have an industry that has to move on and new sources of capital will help," says Jeffrey R. Holzschuh, head of utility and power investment banking at Morgan Stanley.

So financial firms are emerging as significant producers of the nation's electricity. Texas Pacific Group will supply 44% of Oregon residents with power once it receives regulatory approval to buy one of the state's utilities. Goldman produces 6.5% of the power Consolidated Edison Inc. delivers to New York City. If all their deals are completed, financial firms will control an estimated 4% of the nation's power by some point next year, says Platts.

But is a new breed of Wall Street power brokers desirable? Regulators are closely watching to see how financial firms manage what some see as potential conflicts of interest between making hay trading electricity and supplying it. For now, financial firms' money, strong credit ratings, and expertise in managing financial risks are considered a plus. "But we are trying to make sure that what they're doing is within the rules," says William F. Hederman, director of the office of market oversight and investigations at FERC. Goldman says nearly 99% of its power is sold on long-term contracts.

As energy prices soar, will bankers overborrow against their new assets?

Critics worry that bankers, with little operational experience, could end up leaving high-maintenance power plants in bad shape. And there's a fear that they'll borrow too heavily against these assets as energy prices soar, leaving the companies' balance sheets debt-laden once again. "New investors often don't recognize the risk

during periods of high commodity prices," says Cameron O. Smith, senior managing director at Cosco Capital Management LLC. "They may have taken on unanticipated downside risk."

CLOSING WINDOW

SOME ENERGY ASSETS are already starting to look expensive. In September, Credit Suisse First Boston decided to back out of its plan to enter an energy marketing and trading joint venture with TXU Corp. in part because it decided it could build up energy-trading operations more cheaply on its own. A senior banker at another major Wall Street firm, who asks not to be named, says: "We're probably a day late and a dollar short" to buy such a business.

Energy profits could quickly fizzle out if new supplies hit the market any time soon and skyrocketing prices fall back to earth. That would give quite a shock to today's power-crazed traders and bankers. But for now, they're fired up. ■

—By Emily Thornton in New York

The New Power Brokers

Investment banks, buyout shops, and other financial firms are snatching up power plants. Here are some of the bigger deals in the past 12 months:

VALUE*	DEAL
\$3.7 BILLION	Blackstone Group, Hellman & Friedman, Kohlberg Kravis & Roberts, and Texas Pacific Group announce in July they will buy power provider Texas Genco
2.4	Goldman Sachs completes purchase of 26 power plants from Cogentrix Energy in 15 states and the Dominican Republic
2.4	Texas Pacific Group is awaiting regulatory approval to buy Oregon's largest electric utility Portland General Electric
1.9	Goldman Sachs announces in September that it will buy power plants and a natural gas pipeline owned by National Energy & Gas Transmission
0.9	American International Group, through a joint venture called Northern Star Generation, announces it will buy El Paso Corp.'s stakes in up to 25 power plants
0.5	Private equity firm MatlinPatterson buys eight gas-fired power plants from Duke Energy in the southeastern U.S.

*Debt and equity

Data: Platts Global Power Report



Has Deutsche Bank Lost Its Way?

Having failed to complete a merger, Ackermann plans a radical makeover

FOR DEUTSCHE BANK CHIEF Executive Josef Ackermann, 2004 has turned out to be a forgettable year. Three attempts to pull off a big merger—with Citigroup, Germany's Postbank, and Credit Suisse First Boston—failed. The bank's stock is down 6.9%, compared with a 7.9% average gain for other European banks—and bigger gains for international competitors like HSBC. And on Oct. 28 respected board member Ulrich Cartellieri resigned, saying he could no longer support Ackermann's leadership. To cap it off, Ackermann was embroiled in a criminal trial from January to July on charges of aggravated breach of shareholder trust when he was a board member of Mannesmann and it was taken over by Vodafone Group PLC. He was acquitted, but during those seven months Deutsche drifted. "There is no

vision and no strategy," says one former Deutsche banker.

Can Ackermann steer Deutsche out of its rut? He is determined to keep trying. On Sept. 21 he announced a radical reorganization of the bank, redoubling his effort to hit the 25% return on equity he has targeted for 2005. Details of the overhaul will be released with the fourth-quarter results, but analysts say the 56-year-old, Swiss-born CEO will have to deliver cost cuts of up to \$1.3 billion to reach his goal. Insiders say that could cost 6,000 global jobs. Frankfurt and London bankers say the moves are part of a renewed

BELEAGUERED A top board member just quit, criticizing Ackermann

drive to make Deutsche more attractive for a cross-border deal. Insiders say Ackermann has been talking with a slew of potential merger partners, including Lloyds TSB and Barclays. "If [Deutsche] improve profitability, the market will reward them," says Vasco Moreno, bank analyst at Keefe Bruyette & Woods Ltd. in London.

SHOULDER-TO-SHOULDER

DESPITE HIS TRAVAILS, Ackermann has made admirable headway boosting Deutsche Bank's profits. Analysts expect net profit to double this year, to \$3.5 billion, on revenues of \$26 billion. Deutsche has reduced loan losses and solidified gains in investment banking, which contributed 71% of the bank's net profit in 2003. Deutsche ranks No. 6 in announced mergers and acquisitions for 2004 worldwide (No. 10 in the U.S.) and is No. 7 in global debt and equity underwriting, according to Thomson Financial. Return-on-equity has jumped since Ackermann took over, from 1.1% in 2002 to 9% in 2003; the consensus ROE forecast for 2004 is 19%.

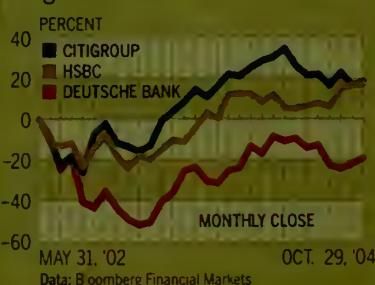
But Deutsche's aim of standing shoulder-to-shoulder with the world's top five investment banks remains elusive. Hampered by a weak presence in the U.S., the bank is No. 21 worldwide in market capitalization, with its \$44 billion market cap a fraction of Citigroup's and other rivals. Critics charge that in his pursuit of a high global profile, Ackermann has neglected Deutsche's home market. "You can only build a strong international business off a strong domestic foundation," says an adviser to Cartellieri. He also cites a "dangerous imbalance" in investment banking, with most of the business in high-risk debt issuance and trading. The bank, he adds, remains "weak" in the

safer areas of equity issuance, advisory, and fund management. Deutsche says it has handle on its risk.

Ackermann insists he isn't neglecting his home market. Indeed in September he created a new German Management Committee to improve domestic business. Sources close to Ackermann say his strategy aim has always been to bolster the stead

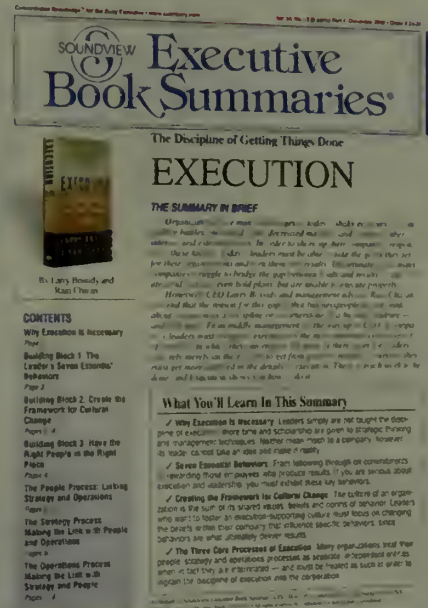
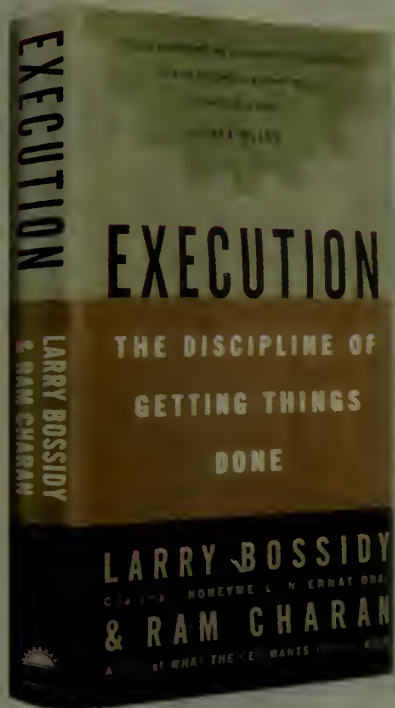
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Since the CEO took over in May, 2002, Deutsche's stock has lagged its global rivals



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income provided by the consumer, corporate, and asset-management businesses, but that gaining credibility in investment banking took priority in his first two years on the job. Now that those credentials are in place, management can focus on fixing Deutsche's German business. "We want to improve our cooperation with our customers significantly," says Jürgen Fitschen, chairman of the new German Management Committee.

POLITICAL PRESSURES

DEUTSCHE BANK intentionally trimmed the ranks of its German clients over the past few years, including giant auto maker Volkswagen, since it was unwilling to continue extending loans at below-market rates—a practice that helped German industry back to its feet in the 1940s but that simply serves to undermine bank profits today. "We are not the state bank of Germany," says a source close to Ackermann. "The key is that we are making money in Germany." Deutsche's retail operations will earn more than \$1 billion this year. Ackermann also has staunchly resisted political pressure from Chancellor Gerhard Schröder and some of his own board members to create a national champion by taking over weak domestic rivals such as Commerzbank—which announced Nov. 8 that it was abolishing most of its investment banking operations and cutting 900 jobs.

Ackermann may well be able to rev up the bank's German operations. But analysts say Deutsche has a long way to go before it makes the kind of global imprint Ackermann and his predecessors have been pursuing for 20 years. Big-league banks such as Citi and J.P. Morgan Chase have a strong advantage in wooing the biggest global companies, including German ones such as DaimlerChrysler, since they have the resources to extend more credit and do more syndicated loans. "The risk is that Deutsche gets aced out of the big corporate clients even in its backyard," says a rival banker.

But Ackermann isn't giving up the quest. He intends to continue hunting for consumer banking franchises in Asia and other European countries. While rival German bankers say Deutsche is running out of time to make a cross-border match, those close to Ackermann say he is not in a hurry. That could be so. But Ackermann's vision for catapulting Deutsche Bank into the global top tier remains a puzzle with missing pieces. ■

—By Gail Edmondson in Frankfurt

Just How Precious Will Gold Get?

Demand is high, supply is scarce, and a weak greenback is hoisting its price

GOLD IS FINALLY GETTING some respect. Four years ago, when it began a steady upward march, only the hardest gold bug believed in the glittery metal. But now, after a 75% climb since early 2001, gold is topping \$435 an ounce, a level not seen since 1988, and the naysayers have gone to ground. "We're in a secular bull market in commodities," says Frank E. Holmes, chief executive of U.S. Global Investors Inc., a mutual-fund company that's bullish on the metal. "Nobody believed oil could go to \$50 a barrel. So why can't gold go to \$500 an ounce?"

The fever is so intense that new competitors are vying to grab business from New York and London, traditional centers of the gold trade. Last month, the Chicago Board of Trade began offering standard 100-ounce gold futures contracts. Dubai plans to open a gold & commodity exchange next year.

Certainly, the stars seem aligned for gold. For one, the Bush Administration apparently doesn't mind a steady decline in the dollar to goose U.S. exports. Gold and the dollar traditionally move in opposite directions. The past few years have been no exception: Since early 2002, the greenback

has fallen 25% against a basket of other currencies, vs. a 56% rise in gold.

In a market dominated by investors and central banks, an often-forgotten factor is demand by consumers and manufacturers. Just as with many other commodities, the rise of Asia is boosting gold prices as everyone from India's jewelry bedecked brides to makers of computers and DVDs in China clamor for the metal.

Scarcity is driving prices higher still. Mining companies survived the doldrums after gold's plunge from nearly \$900 in 1980 by pruning exploration and closing marginal mines. Even miners step up investment, says Gregory C. Wilkins, CEO of Toronto's Barrick Gold Corp., it could be years before they dig out major new supplies.

Of course, gold's price ride won't last indefinitely. Inflation still appears to be under control. Federal Reserve rate hikes in the months ahead could boost the dollar. And demand for gold might slip if global growth eases. Says Mark M. Zandi, chief economist for Econmy.com Inc., a consulting firm in West Chester, Pa.: "The bottom line is that gold prices are tilted higher, but they're not going to take off." For now, the world's gold bugs are betting he's wrong. ■

—By Joseph Weber in Chicago



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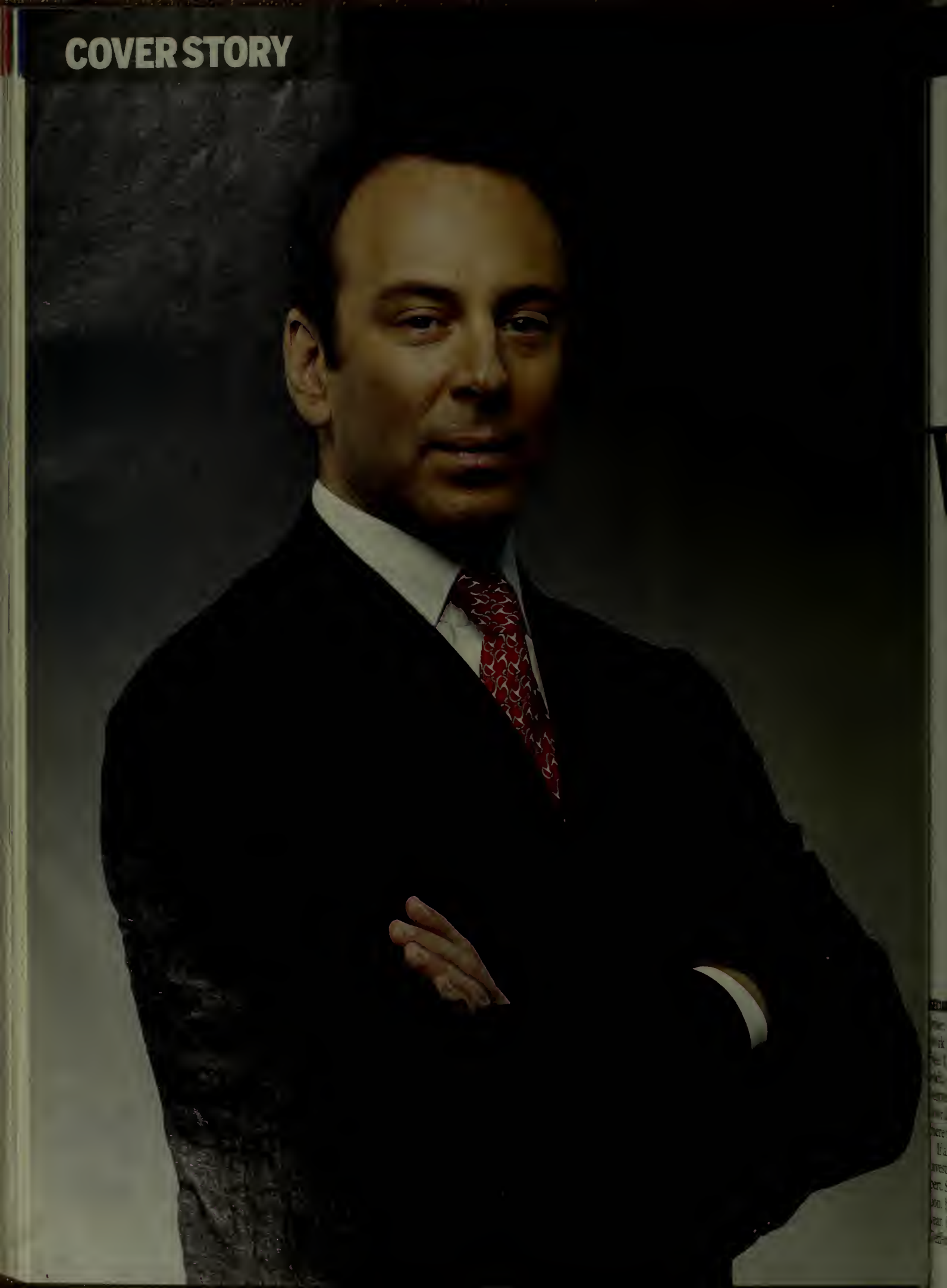
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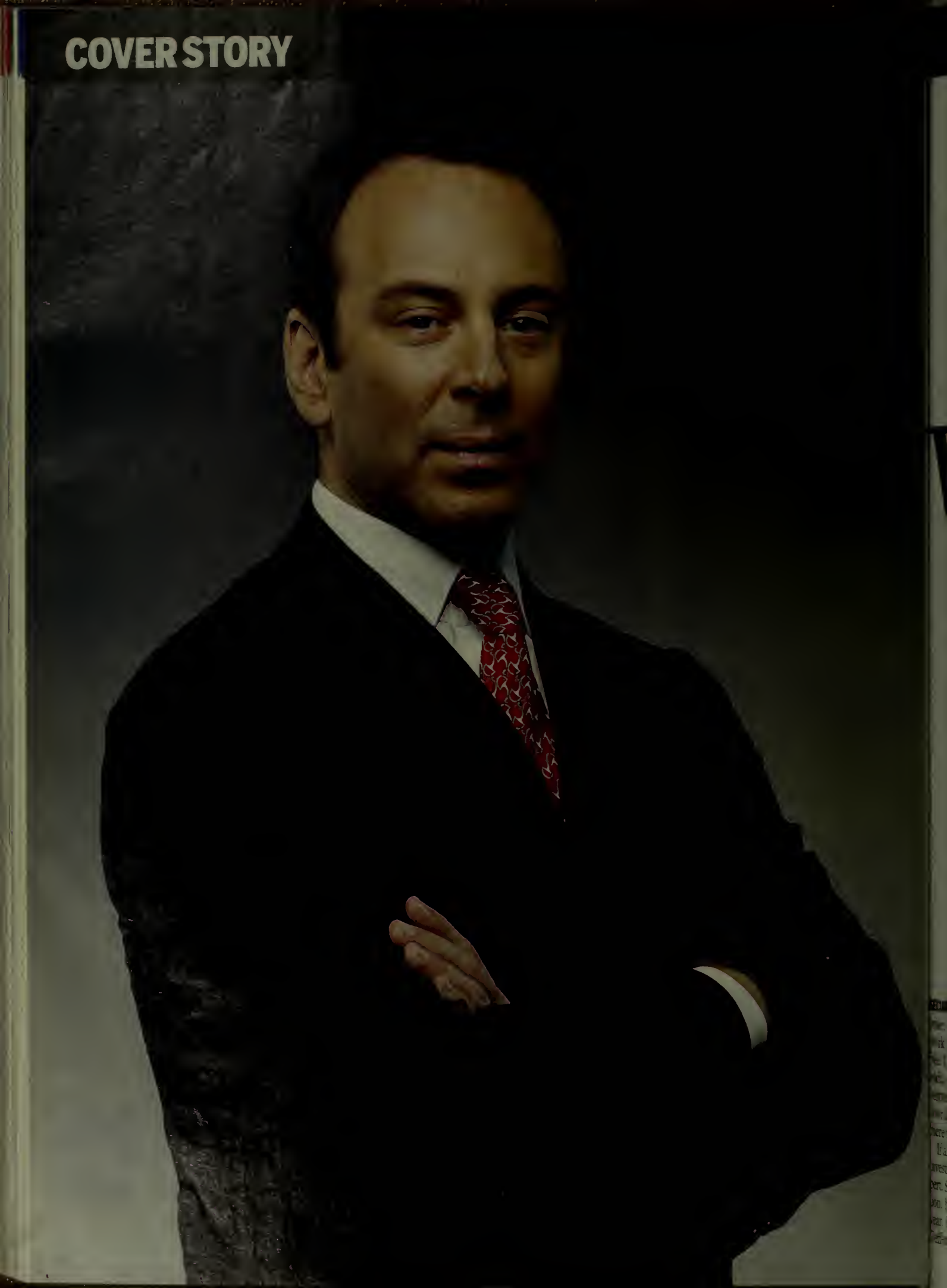
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COVER STORY

A large, dark, high-contrast portrait of a man in a suit and tie, standing with his arms crossed. The man is looking slightly to the side. The background is dark and textured. The man is wearing a dark suit jacket, a white shirt, and a red tie with a white pattern. The lighting is dramatic, with strong highlights on his face and suit, and deep shadows elsewhere. The overall mood is serious and professional.

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The Next Warren Buffett?

FINANCIER **EDDIE LAMPERT** TURNED ONCE-BANKRUPT K MART INTO A \$3 BILLION CASH COW. WILL HE BUILD IT INTO A NEW BERKSHIRE HATHAWAY?

By Robert Berner

SECURITY IS TIGHT AT EDDIE LAMPERT'S OFFICE. THAT'S NO SURPRISE: Last year he was kidnapped at gunpoint while leaving work and held for ransom for two days before talking his way free. In fact, there is no sign on the low-rise building in Greenwich, Conn., that his \$9 billion private investment fund, ESL Investments Inc., is even there at all. There's also no sign on ESL's door upstairs—and certainly no indication that the man sitting there might be the next Warren E. Buffett.

If anyone is destined to inherit Buffett's perch as the leading investment wizard of his day, it just might be Edward S. Lampert. Since he started ESL in 1988 with a grubstake of \$28 million, he has racked up Buffett-style returns averaging 29% a year. His top-drawer clients range from media mogul David Geffen and Dell Inc. founder Michael S. Dell to the Tisch fami-

ly of Loews Corp. and the Ziff family publishing heirs. Only 42, Lampert has amassed a fortune estimated at nearly \$2 billion. So focused is he on his goals that he was back at work negotiating a big deal two days after his kidnappers released him. Says Thomas J. Tisch, son of Loews's founder Laurence Tisch: "Eddie is one of the extraordinary investors of our age, if not the most extraordinary."

Like the 74-year-old Buffett, Lampert has built his success on some of the least sexy investments around. He searches for companies that are seriously undervalued, and he'll even risk jumping into ones that are reeling from bad management or lousy strategies—because the potential returns are far greater. Right now, ESL has stakes in a grab bag of retailers. It holds 14.6% of Sears, Roebuck & Co., whose stock soared 24% on

JOE McNALLY

Nov. 5 after real estate investment trust Vornado Realty Trust bought a 4.3% stake. It also owns a big chunk of the No. 1 auto-parts retailer, AutoZone Inc., and the biggest national chain of car dealers, AutoNation Inc., as well as a small stake in telecom giant MCI.

The key to his ambitions, though, is a 53% stake in Kmart Holding Corp. If a fading textile maker in New Bedford, Mass., called Berkshire Hathaway Inc. provided the launchpad for Buffett, then Kmart might do the same for Lampert. Much like the textile mill when Buffett got hold of it, the once-bankrupt Kmart is now throwing off far more cash—it has \$3 billion on hand—than it can use in the business. It also has \$3.8 billion in accumulated tax credits, which can offset taxes on future income, and a fast-rising stock that is valuable in deal-making.

Those advantages make Kmart a perfect vehicle for bankrolling big acquisitions. They give Lampert “the ability to buy a lot of companies and shield a lot of income from taxes,” says John C. Phelan, a former ESL principal who is now managing partner of MSD Capital, which also manages Dell family money.

A Key Signal

THE FIRST HINT Buffett gave of how he planned to transform Berkshire into an investment powerhouse was in regulatory filings in the late 1960s. In an echo of that move, Kmart disclosed in August that the board had given Lampert authority to invest Kmart’s “surplus cash” in other businesses. Wall Street is reading that move as a signal that Kmart may be on the way to becoming Lampert’s Berkshire Hathaway. “There is no question he will turn Kmart into an investment vehicle like Warren Buffett’s,” says legendary value investor Martin Whitman. He runs Third Avenue Management LLC, which teamed up with Lampert when Kmart was in bankruptcy court and now owns a 4.6% stake in the retailer. “That’s what I am valuing into the stock.”

For Lampert, more than just superior investment returns are riding on Kmart. In a series of lengthy interviews with *BusinessWeek*, he makes clear that he also wants to earn respect as a businessman who provides expertise in how a company is run. Like Buffett, he wants chief executives to open their arms and partner with him. Dressed in a hand-tailored suit with a subtle pinstripe and an open-collared blue-striped shirt, he acknowledges that his role model is a tough comparison. Berkshire Hathaway has earned 25% a year since

Buffett gained control in 1965—not quite as much as ESL’s 29 average return but over a far longer period. “Buffett’s investments have stood the test of time,” he says, noting that the same test will be applied to him. Buffett, for his part, declines to comment on Lampert.

From the start of his career, Lampert has sought out high-powered mentors. At various stages he worked with former Goldman Sachs & Co. head Robert E. Rubin, economics Nobel laureate James Tobin, and investor Richard Rainwater. Rubin, now at Citigroup, was taken by his self-assurance, independence and discipline when Lampert worked for him at Goldman after graduating from Yale University. When Lampert, then 25, told him he was leaving to start his own fund, the future Treasury Secretary argued that he was forfeiting a golden career. “I

had a clear-eyed view of the risk I was taking and the likelihood I would succeed,” Rubin recalls. “I’d say it worked.”

Kmart is a classic example of how Lampert works. He got control of the \$23 billion retail chain—the nation’s third-largest discounter, behind Wal-Mart Stores Inc. and Target Corp.—for less than \$1 billion in bankruptcy court. He emerged as the largest shareholder and became chairman 18 months ago as part of a reorganization in which virtually all of its debt was converted into shares. Lampert’s goal is to keep Kmart humming so it can continue throwing off cash. Even if Kmart eventually fails, keeping it going as long as possible lets him extract top dollar for its valuable real estate by selling the stores over time. “We are going to have to generate traffic [in the stores],” says investor Whitman. “Even to this day, it is no slam dunk.”

So far, Lampert has been milking Kmart for cash. Although same-store sales continue to sink, the company has been in the black for the past three quarters because cash flow has surged. A favorite Lampert gripe: Retailers are too willing to chase unprofitable sales. Instead, he has imposed a program of keeping the lid on capital spending, holding inventory down, and stopping the endless clearance sales. And he pushed for Kmart to sell 68 stores to Home Depot Inc. and Sears to raise a total of \$846.9 million. That’s nearly as much as the \$879 million value placed on all of Kmart’s real estate—1,513 stores, 16 distribution centers and the fixtures—in bankruptcy proceedings. Thanks to the measure Lampert has put in place, says UBS analyst Gary Balter, Kmart could have as much as \$4.2 billion of cash in hand by the end of next year’s first quarter.

Lampert is also angling to boost profits at a smaller, more focused Kmart. He has quietly consulted for



LEARNING FROM THE MASTER

Eddie Lampert’s investment style is similar to Warren Buffett’s. They both:

- Look for companies with long-term value that the markets are missing
- Invest at a low enough price to protect their downside
- Buy a few companies they know intimately
- Seek out mature and easily understandable companies that throw off lots of cash; avoid tech
- Act like businessmen who team up with CEOs and influence the way companies are run
- Focus intensely on how their companies allocate capital to maximize returns

But there’s one big difference between the two:

- Buffett invests largely in well-run companies, while Lampert is more willing to target poorly run ones because they can produce greater returns if the right changes are made. As a result, Lampert is more hands-on with management.

Data: BusinessWeek

BARGAIN HUNTER

Lampert got the
\$23 billion
chain for less
than \$1 billion



RETAIL ALCHEMY

Lampert has turned investments in lackluster companies into big bucks

Data: Securities & Exchange Commission filings, Bloomberg Financial Markets, BusinessWeek

	Kmart Holding Discount retailer	AutoZone Auto-parts retailer	AutoNation Car-dealership chain	Sears Roebuck Department-store chain	MCI Telecom provider
STAKE	52.6%	26.8%	28.5%	14.6%	6.4%
CURRENT VALUE	\$4.54 Billion	\$1.8 Billion	\$1.3 Billion	\$1.38 Billion	\$375 Million
INCREASE IN SHARE PRICE*	543% since May 6, 2003	320% since 1997	150% since mid-2002**	100% since Oct. 2002**	10% since April 20

*Through Nov. 9 **Since stake became public

mer Gap Inc. Chief Executive Millard Drexler on apparel strategy and hired two former Gap merchandising and design executives as a result. One of their first moves was to add four up-market brands to Kmart's clothing lineup, which will widen margins. And Kmart is beefing up its consumer electronics selection, adding such brands as Sony. Lampert has also retained the architectural firm Pompei A.D. LLC, which designs interiors for teen retailer Urban Outfitters Inc., to start testing a much-needed redesign of Kmart's stodgy outlets. And on Oct. 18 he named a new CEO, Aylwin Lewis, a PepsiCo Inc. veteran who's expected to sharpen the chain's operations and marketing. Even before that move, Kmart resumed TV advertising and for the first time ran apparel ads in *Vogue* and *Vanity Fair* in a bid to outdo rival Target and present a hipper image.

But investors aren't thinking about Kmart's trendier clothes or blue-light specials as they snap up its soaring stock. Indeed, after climbing from \$15 a share to \$96 in 18 months, Kmart's stock sports a Buffett-like premium. The company now boasts

a stock-market capitalization of \$8.6 billion, on a par with Federated Department Stores Inc., the No. 1 department-store company and owner of Bloomingdale's and Macy's. "Why would it reflect that kind of value?" asks Robert Miller, a principal at Miller Mathes, a New York-based restructuring advisory firm. "Because Lampert is a smart cookie. Essentially he is transforming the assets into a more valuable state."

Studying the Sage

IF LAMPERT DOES turn Kmart into the next Berkshire Hathaway, he could simply follow Buffett's blueprint. Buffett started with an investment fund he founded at age 25, the same as Lampert when he started ESL. Then in 1962, Buffett started to buy shares of the textile company and by the late 1960s he was using the mill's excess cash to invest in other businesses—first a Nebraska insurance company and then an Illinois bank. By

» Friends trace Lampert's drive to succeed to the shock of his father's death from a heart attack at age 47

1970 he had dissolved the fund, selling off its investments and giving the partners a choice of cash or shares in Berkshire Hathaway. Many investors believe that Lampert is poised to do the same: using Kmart to make new investments while keeping ESL for his earlier investments, or alternatively dissolving it at some point by selling its assets.

Lampert has carefully studied Buffett for years. He started reading and rereading Buffett's writings while working at Goldman after college. He would analyze Buffett's investments, he says, by "reverse engineering" deals, such as his purchase of insurance company GEICO. Lampert went back and read GEICO's annual reports in the couple of years preceding Buffett's initial investment in the 1970s. "Putting myself in his shoes at that time, could I understand why he made the investments?" says Lampert. "That was part of my learning process." In 1989 he flew out to Omaha and met Buffett for 90 minutes, peppering him with questions about his investing philosophy.

Like the Sage of Omaha, Lampert targets mature and easily understandable businesses that have strong cash flows. Both focus on a company's ability to generate large amounts of cash over the long haul, so neither is particularly fazed by sharp ups and downs in profits and stock prices. In fact, says ESL President William C. Crowley, "Lampert would rather earn a bumpy 15% [return] than a flat 12%." And just as Buffett progressed from minority stakes, where his influence isn't guaranteed, to majority stakes, where he has control, Lampert is currently following the same path. Kmart marks his first majority play, and Lampert says it is the type of investment he plans for the future. "In a control position, our ability to create value goes up exponentially," he explains.

Watch the Pennies

THERE IS NOTHING Lampert likes to control more than how money is spent. He is probably even more obsessed than Buffett with making sure that every dollar he invests in a company earns the highest return. That means his companies have often used cash to buy back shares rather than boost capital spending. The CEOs of his companies, who are reluctant to talk without Lampert's permission, say a big part of their conversations with him focus on discussing how best to allocate capital. "He

will always want to work through, at a pretty high level of detail, what we are going to spend our money on and what the business benefits will be," says Julian C. Day, who was Kmart's CEO until October and now is a director. Adds Richard Perry, who worked with Lampert at Goldman and whose hedge fund owns a major stake in Kmart: "Eddie doesn't waste money—ever."

For all their similarities, Lampert is no Buffett clone. For one thing, he can be much more assertive with management. He played rough at AutoZone, where he started amassing shares in 1997. After his stake reached 15.7% he got a board seat in 1999. The management tried to crimp his power, but Lampert ran rings around them. CEO John C. Adams Jr. left shortly afterward. Adams says he voluntarily retired.

Lampert runs a tight ship at ESL, too. Not a penny gets invested without his approval, say former employees. His analysts either research Lampert's ideas or bring their own to him.

Gavin Abrams, an ESL analyst in the second half of the 1990s, says Lampert has an uncanny ability to see how the pieces of an investment fit together. "When an art critic looks at a piece of art, he can talk to you not just about the color and technique but the history and where it fits into art in general," he says. "Eddie talks about an investment the same way." Consider Sears' recent purchase of 50 Kmart stores. The deal will both jump-start Sears' strategy to move outside of malls and build stand-alone big-box stores and add hundreds of millions more to Kmart's growing cash pile. "Great investors see deals within deals," says William E. Oberndorf, general partner of the SPO Partners & Co. value fund. "He's in rarified company."

What struck former ESL analyst Daniel Pike was how well Lampert understands risk. "He's obsessed with protecting his downside," he says. Lampert does this by holding just seven or eight major investments at a time—investments he knows intimately after intensive research. Pike recalls

getting a taste of Lampert's methods when he applied to work there after quitting an investment-banking job at about the time ESL was investing in AutoZone. Before hiring Pike, Lampert sent him on a grueling, all-expenses-paid field trip to visit auto-parts retailers throughout the country for a month to test his smarts.

Once ESL has invested, it stays in close touch with the company. ESL President Crowley, 47, a former Goldman Sachs banker, is Lampert's main point person. He also sits on Kmart's board and oversees the chain's finances. Former Kmart CEO Day says he got calls daily from Crowley on operational issues and discussed strategy with Lampert two to three times a week. At AutoZone, where ESL holds a 26.8% stake and Lampert sits on the board, Chairman and CEO Steve Odland says he talks to Lampert about three times a month.

One former employee notes that Lampert's annual letters to investors have gotten shorter over the years. These days they're about two pages long. In each, he makes the standard Buffett point: That year's performance will be hard to match in the future. Given the outside returns he achieves, investors aren't inclined to bug him for more details. "Based on the

WRINGING VALUE OUT OF KMART

Armed with the discount chain's vast real estate holdings to protect his downside, Lampert is retooling Kmart to maximize cash flow. So far he has:

CLEANED UP the balance sheet by converting most debt to equity before the chain emerged from bankruptcy in 2003

SOLD 68 marginal stores to Sears and Home Depot

STRETCHED OUT payments to vendors, reduced inventories, raised prices, and kept a lid on capital spending

CREATED four higher-quality apparel brands and in February will add a line of kitchenware and other home goods to goose sales and profits

Data: BusinessWeek

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way he thinks about investments, I trust Eddie,” says Tisch.

Lampert runs his fund with just 15 employees, mostly research analysts. As Lampert walks the floor, Crowley is locked on the phone in his office. Lampert’s is next door, a corner suite whose central focus is a dual set of black, flat-panel computer screens perched on his desk. Most of the room is lined with books, but on one wall hangs a picture of Lampert with former President George H.W. Bush. Outside, several people work silently in neatly kept cubicles. Lampert notes how quiet and unlike a trading floor the office is. “It’s a more studious atmosphere,” he jokes.

Friends trace Lampert’s intense drive to succeed to the shock of his father’s death from a heart attack at 47. Overnight, young Eddie became the man of the house at just 14. The family lived in the prosperous suburb of Roslyn, N.Y., and his father, Floyd, a lawyer in New York City, had been deeply involved with both Lampert and his younger sister, Tracey, coaching Little League and teaching them bridge. His stay-at-home mother had to go off to work as a clerk at Saks Fifth Avenue, and financial security was a big issue. “Eddie really assumed the responsibility, knowing that life had changed and we had to accomplish something by ourselves now,” says his mother, Dolores.

It was Lampert’s grandmother who sparked Lampert’s interest in investing. She would watch Louis Rukeyser’s *Wall Street Week* on TV religiously and invest in stocks such as Coca-Cola Co. that paid large dividends. From the age of about 10, his mother recalls, Eddie would sit at his grandmother’s knee as she read stock

» Lampert persuaded his kidnappers to let him go—on a promise that he would pay them \$40,000 in a few days

quotes in the paper and they would talk about her investments. By the ninth grade, while he was watching sports on TV with his buddies, Lampert would also be reading corporate reports or finance textbooks, says Jonathan Cohen, Lampert’s closest childhood friend. “He would mark things with a highlighter,” says Cohen who believes the death of Lampert’s father must play some role in “his need for financial success.” Surely, his father’s death left a big hole in his psyche. At his wedding in 2001, held outdoors on his Greenwich estate, he looked up into the sky and made a toast: “How am I doing, Dad?” Dolores recalls him saying.

“A Light Burning”

COBBLING TOGETHER FINANCIAL AID, savings from summer jobs, and student loans, Lampert enrolled at Yale University where he majored in economics. There, he served as Phi Beta Kappa president for his class, joined the elite Skull & Bones secret society—and began to seek out the mentors who would propel his career. Says Earl G. Graves Jr., president of *Black Enterprise* magazine, who was in Skull & Bones with Lampert: “I remember telling my girlfriend there is a light burning in this guy that doesn’t burn in many people.” In his last three years at Yale Lampert worked as a research assistant for Professor James Tobin, who had just won the Nobel prize in economics in 1981. Lampert also was a member of the Yale student investment club, a group on campus that invested donations from alumni that eventually became part of Yale’s endowment. Joseph “Skip” Klein, student chairman of the group, says Lampert would suggest complex investments such as risk-arbitrage plays: “Most of us [wondered]: ‘How the heck does he know about this?’”

Lampert parlayed a summer internship at Goldman Sachs into a full-time job upon graduation in 1984. But he didn’t start on the ground floor. Instead, he persuaded Rubin, who oversaw the fixed-income and arbitrage departments, to allow him to work directly for Rubin on special projects. Within months, that translated into a job in Goldman’s high-powered arbitrage department. Lampert thrived on the work, which entailed analyzing whether a just-announced transaction, such as a takeover, would succeed and then betting millions on the outcome—all in minutes. He says the experience taught him how to evaluate risk quickly in a situation, often with incomplete information. Doing this day after day as news events broke offered the best investment training possible, he adds. “It’s like shooting layoffs or foul shots.”

Even in a department filled with hotshots, Lampert stood out, says Frank P. Brosens, who became Lampert’s boss when Rubin became co-CEO of Goldman. He remembers how Lampert argued during the summer before the October, 1987, market crash that stocks were overvalued, given that long-term interest rates were so high. As a result, the department cut its stock holdings by 30% before the crash. “Eddie was the most independent thinker in our area,” Brosens says.

At a time when most people his age are just getting started a

TOP DRAWER

Lampert sought out high-powered mentors...



ROBERT RUBIN
Former Treasury Secretary



RICHARD RAINWATER
Fund manager



JAMES TOBIN
Nobel laureate in economics

... As well as wealthy and influential investors



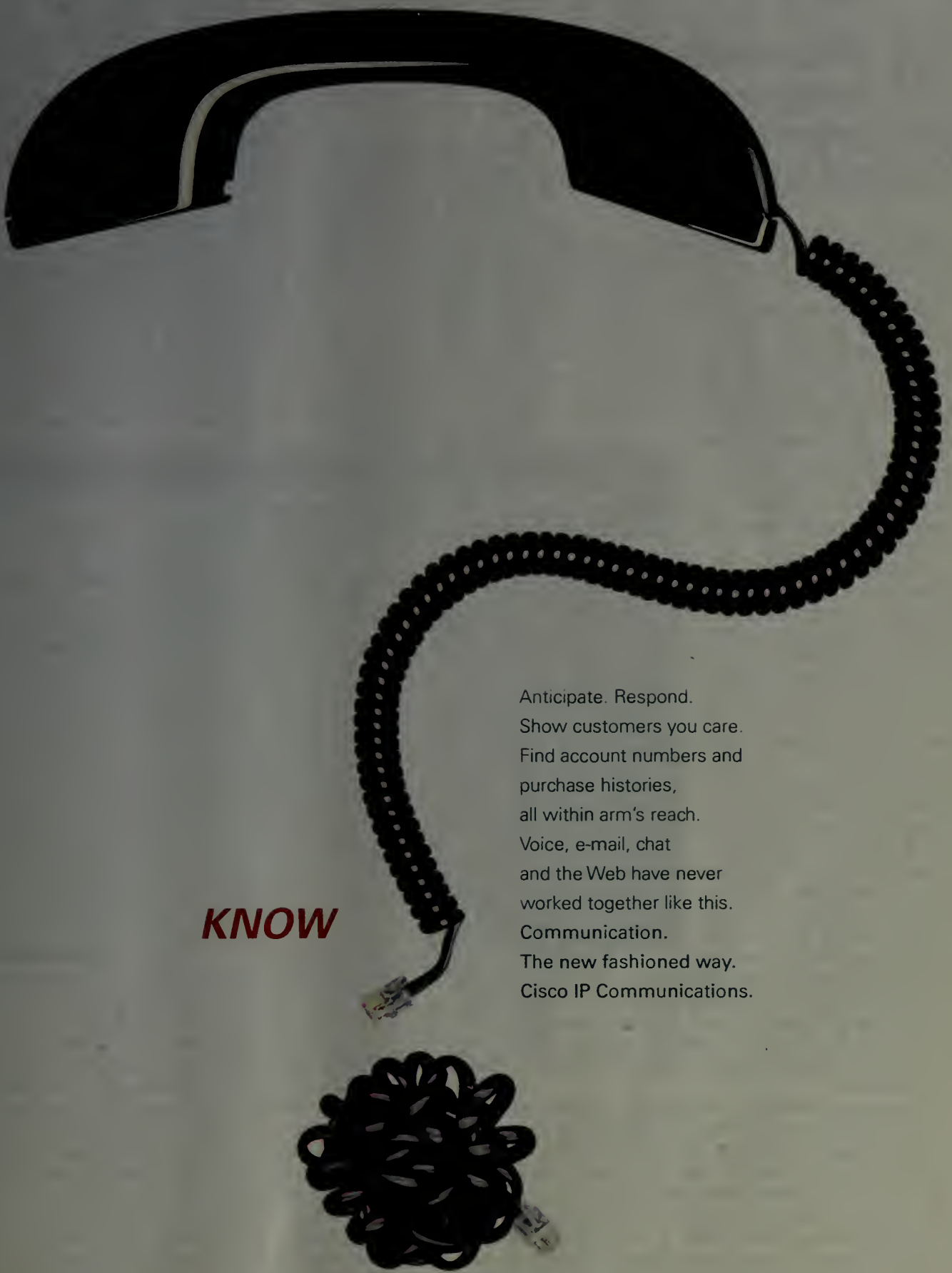
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purchase histories,
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» The audacity of his Kmart investment is what really put Lampert on the map. He scooped up debt as others fled

Goldman, Lampert quit and moved to Fort Worth in 1988. He had met Richard E. Rainwater, the fund manager for the Bass family and other well-heeled clients, the summer before on Nantucket Island. Rainwater invited him to use his offices and gave him a chunk of the \$28 million in seed money for a fund, which Lampert named ESL—his own initials. Rainwater also introduced him to high-powered clients such as Geffen. But Lampert and Rainwater later had a falling out, which neither will discuss. Shareholder activist Robert A.G. Monks, who temporarily worked in Rainwater's offices with Lampert, says it was over control of the fund's investments. Rainwater pulled his money out of ESL, but most other clients stayed.

The audacity of his Kmart investment put Lampert on the map. With Kmart in Chapter 11 in 2002, he scooped up its debt as creditors fled. But his investment swooned as the retailer got even sicker. So Lampert doubled down and bought yet more debt, enough to give him control of the bankruptcy process. Then in January, 2003, at the height of the negotiations, Lampert was leaving ESL on a Friday night when he was kidnapped in the parking garage. Four hoodlums, led by a 23-year-old ex-Marine, had targeted Lampert after a search for rich people on the Internet.

They stuffed him into a Ford Blazer, took him to a cheap motel, and held him bound in the bathtub. They called Lampert's wife, Kinga, playing a tape of his voice. Court documents are sealed, but one person close to the case says the men told Lampert they had been hired to kill him for \$5 million but would let him go for \$1 million.

Lampert was convinced he was going to be killed, he says in his first public comments on the kidnapping case. "Your imagination goes absolutely wild. I was thinking about my mother and my son and my wife. What would their lives be like? Would it be painful when they shot me?" In the adjoining room, he recalls, the television was switched on to the news about the search for the body of Laci Peterson. But as the kidnappers became increasingly nervous, Lampert convinced them that if they let him go, he would pay them \$40,000 a couple of days later, the source says. The hoodlums let him off on the side of a road in Greenwich early on that Sunday morning and were later arrested and convicted. Lampert arrived home to a house full of friends who had been camping out, waiting for news. "It was very much like going to your own

funeral," he says. He was soon back in Kmart negotiations.

So far, Kmart has proved to be a big success. But the track record of ESL's Sears investment has been spotty. Lampert won't discuss the company, where he isn't on the board, but notes that he hasn't sold any shares. In a move that Lampert supported—some say influenced—Sears sold its \$28 billion credit-card business last year to raise cash. Initially, the stock jumped but then fell back because of deteriorating results, until recently. So the jury is out on whether Sears is better off without credit cards, once its biggest source of profits. As with Kmart, Lampert's probable safety net is Sears' real estate, Vornado—which bought the big Sears stake this month—evidently agrees. As Sears scrambles to develop new big-box stores, its traditional mall-based department stores could prove more valuable to others.

On the other hand, ESL's 26.8% stake in AutoZone continues to be a big winner. Although the shares are down 17% from last year's peak of \$103, they're up 320% from 1997, when Lampert started buying. Its margins remain the envy of other auto-parts retailers. Still, weakening same-store sales and recent quarterly

BIO

EDWARD S. LAMPERT



CURRENT POSITION Chairman of ESL Investments and Kmart Holding

BORN July 19, 1962, in Roslyn, N.Y.

EDUCATION B.S. in economics, Yale University, 1984

HERO Berkshire Hathaway Chairman Warren Buffett, whom he has met only twice, once in Omaha in 1989 and later at a dinner in New York.

JULY, 1969

Eddie Lampert at 7 with his father, Floyd, a lawyer in New York

INVESTMENT PHILOSOPHY

"Evaluating risk and valuing risk is really what it is all about."

FAVORITE BOOKS

Philip A. Fisher's 1958 classic *Common Stocks and Uncommon Profits* and Ayn Rand's *Atlas Shrugged*, which he handed out in an audio version to guests at ESL's annual investors' dinner in 2001.

FAMILY Wife, Kinga, 31, a former corporate lawyer. They met on a blind date set up by a friend they had in common. The couple has a son and a daughter.

Data: BusinessWeek

profit misses have led some analysts to contend that the retailer has underinvested in its business and kept prices too high while spending too much on share buybacks.

Lampert and Buffett crossed paths in dealmaking in the early '90s. In 1989 and 1990, Buffett bought a 19.9% stake in PS Group, which ran a stagnant aircraft-leasing business. Buffett made the investment—which caught Lampert's eye—because of a promising new division that would recycle industrial metals, but that unit ran into trouble. As PS Group's stock sank, Lampert jumped in, attracted by the value of the PS aircraft, and began amassing a 19.7% stake at bargain-basement prices in 1993.

Buffett stayed on the sidelines, recalls Larry Guske, PS Group's vice-president for finance, but Lampert—convinced he had no future—kept prodding management to sell assets and pay dividends. In the end, Lampert doubled his money while Buffett lost about a third of his—because he had paid much more for his shares, Guske calculates. Buffett's overall record will be extremely hard to beat. But at least in this instance, the pupil had outperformed the master. ■

—With Susann Rutledge in New York



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Rumble in Regional Sports



CHICAGO The Blackhawks, Bulls, Cubs, and White Sox have switched from Fox to Comcast

With Comcast—and teams themselves—airing local games, Fox is losing ground

THERE'S PLENTY OF SWEAT trickling onto playing fields and courts every week. But the biggest battle in sports today is being waged by the suits on the sidelines fighting over local team programming.

Look no further than Sacramento for a taste of the game. At 7:30 a.m. on the day the Sacramento Kings' pact with its long-time TV carrier, Fox Sports Net Bay Area, was to expire, executives at Kings parent Maloof Sports & Entertainment were already in a meeting. They were talking to cable giant Comcast Corp.—Fox's rival—to iron out a new TV deal. By the time the season kicked off on Nov. 2, the Kings were signed up for a 10-year run on the newly created Comcast SportsNet West. In turn, when it looked as if the Memphis Grizzlies might launch their own sports network, Fox Sports South jumped in just ahead of the season's tip-off and offered the team a six-year deal to drop its cable plans. Fox promised to show 60 games this year, vs. 25 last season.

The hottest rivalry in regional sports is between two big foes, Fox parent News Corp. and Comcast. It's the latest iteration

of the media giants' contest to win over America's TV viewers. And it's essentially Fox's battle to lose. As ESPN was building itself into a national franchise, Fox Sports Networks decided to go local. Fox Sports Chief Executive David Hill proclaimed that all sports are "tribal" and launched a bunch of regional sports networks (RSNs), many in partnership with cable operator Cablevision Systems Corp., to tap the passion of regional fans for their local teams. Fox has ruled regional sports ever since—until now.

It's no surprise that others want in: RSNs generate tons of cash by commanding the second-highest fees, as much as \$2 per subscriber a month, next to ESPN, at \$2.25 per subscriber. (In contrast, CNN gets about 40¢.) "These sports networks are all about instant cash flow. Advertising is the icing on the cake," says TV consultant Mike Trager. Comcast, with cable systems in 22 of the 25 largest U.S.

cities, is looking to RSNs to build its brand and exert greater control over the escalating fees it pays for sports. Sports teams are entering the fray, too: With player payroll and stadium debt hitting all-time highs, they're looking to cut out costly middlemen by creating their own TV channels.

BRANDING OPPORTUNITY

COMCAST IS MAKING the most inroad by joining with teams in New York and Chicago to launch new sports networks in each case luring teams away from tigh-fisted Cablevision, whose sports networks operate as affiliates of Fox Sports. Controlling local sports channels is a great way to promote itself to rabid fans and gives the company a platform to sell such services as high-speed data and video-on-demand. "Having your name attached

to a local sports network is a huge branding opportunity," says Comcast COO Steve Burke. Its RSNs also give Comcast leverage in negotiating fees it pays to News Corp. to carry FX, Fox News, and other channels.

The biggest blow to the Fox Sports-Cablevision duo came in sports-market Chicago in October, when Comcast debuted its new RSN, a partnership with the NBA's Bulls, the NHL's Blackhawks, and

In Decline
Number of pro teams whose games are broadcast locally by Fox:

2000	73 of 79
2004	62 of 82

Data: Fox Sports Network


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COMMENTARY

BY TOM LOWRY AND RONALD GROVER

Football's Fear Factor

Why the TV networks are throwing cash at the NFL

FINANCIAL HOME RUNS

IN ALL, THE FOX Sports New York has lost the rights to 11 teams since 2000, according to Fox. Today it controls rights to 62 of the nation's 82 pro teams, excluding pro football. "They're losing eyeballs, and that means lower revenues from national advertisers," says Sanford C. Bernstein & Co. analyst Craig Moffett. "It will eventually lower fees from cable operators."

Teams doing TV on their own are also a worry for Fox. Emboldened by the financial home runs by sports networks launched by the New York Yankees and the Boston Red Sox, as many as 25 pro teams own or are planning their own networks, says consultant Lee H. Berke, who advised the Yankees in creating the YES network in 2002. "You see more teams adopting our model," says Sean P. McGrail, president of the Red Sox' 20-year-old New England Sports Network (NESN).

Still, not every team can pull off its own sports channel. Baseball's Kansas City Royals and Minnesota Twins and the NBA's Portland Trail Blazers all folded their channels after losses and being dropped by cable and satellite companies. The counter-offers to teams are getting richer, too. On Nov. 8, Fox said it had averted another planned team-owned channel by offering an estimated 15-year, \$600 million deal to the Houston Rockets and Astros. The teams and Fox had been fighting in court since 2003.

Fox Sports execs figure they can beat back Comcast and outlast the solo-team channels. "We're not going away," says Randy Freer, Fox Sports Nets' chief operating officer. It promises to be a nasty rumble: Rumors persist that Comcast wants to buy Cablevision's sports channels in San Francisco, Florida, and New England. That surely will elevate the local-sports grab to championship status. ■

—By Ronald Grover in Los Angeles
and Tom Lowry in New York, with
William C. Symonds in Boston

HAVE NETWORK TV executives gone mad? It would appear so, based on the Nov. 8 announcement that CBS and Fox will spend \$8 billion through 2011 for the rights to broadcast National Football League games on Sunday afternoons. That's more than 25% more than the networks shelled out for their last deal, which isn't due to expire until the Super Bowl in 2006. What's more, it comes at a time when network TV audiences are evaporating amid an explosion of entertainment choices—and cost-conscious moguls are packing their schedules with endless variations of cheap-to-produce reality shows. (Maybe that's where they've really gone mad).

So what makes a bunch of trash-talkin' guys smashing into each other every week worth so much? Some network execs still insist they make money on the NFL—though analysts dispute that. But for outlets that must now compete with hundreds of cable channels, iPods, wireless devices, satellite radio, and good ol' PlayStation, Sunday afternoon football may just be the last bastion of a mass audience for network TV. The NFL's ratings are down almost 9% since 1998, but its broadcasts still average 15.5 million viewers, according to Nielsen Media Research. (The average network audience for a baseball game is 3.6 million.) And the games are live,

THE LAST BIG SCORE?

In a fragmented era, a semi-mass audience

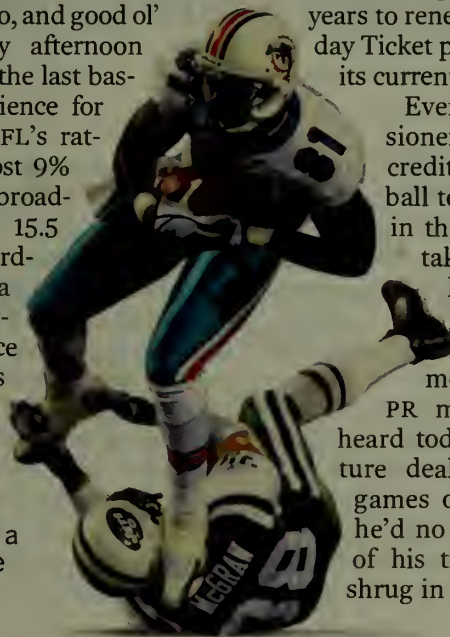
which makes them TiVo-proof these days since, after all, who wants to watch a game when everybody knows the score?

In a further sign of the NFL's leverage, Fox and CBS agreed to give up four games each on their season schedule to the NFL, enabling it for the first time to offer a package for Thursday night and Saturday broadcasts. The league will also have the right to pick what games run on Monday nights in the second half of the season, an attempt to bolster ratings with more competitive matchups and, ultimately, raise the price for the Monday TV contract.

Dealmaking will be even more interesting in coming weeks as the NFL negotiates with its prime-time TV partner, Walt Disney Co., whose ABC airs Monday Night games and whose cable unit ESPN shows Sunday night games. Getting CBS and Fox on board so early with new deals is clearly a way to nudge Disney. And rumors have it that Time Warner's Turner Broadcasting System is interested, as well as NBC Universal, with its USA Network.

The networks aren't the only ones shelling out big bucks for NFL games. News Corp.'s DirecTV Group said on Nov. 8 that it will pay \$3.5 billion over five years to renew its exclusive NFL Sunday Ticket package, a 75% jump over its current package.

Even the late NFL Commissioner Pete Rozelle, who is credited with marrying football to a national TV audience in the early 1960s, might be taken aback by all the billions pouring into the NFL's Park Avenue digs. Nobody understood the media better than that ex-PR man Rozelle. But if he heard today's talk about how future deals might one day put games on cell phones or PDAs, he'd no doubt take a long drag of his trademark cigarette and shrug in amazement. ■





Expanding J.D.'s Power

Consumers trust him. Companies fear him. Now the rater is taking his act wider

OVER THE PAST 36 YEARS, J.D. "Dave" Power has earned a reputation as high priest of customer satisfaction. His company, J.D. Power & Associates, can put even the most commanding carmaker in a tizzy with a less-than-terrific rating of a new car. Power has expanded his empire to include ratings of everything from hospitals to satellite dishes. And the 73-year-old statistician isn't done. His new targets: auditors, which J.D. Power ranked publicly for the first time in a survey published on Nov. 9.

Power has come a long way from the days when he and his late wife, Julie, tabulated survey responses on their kitchen table in Calabasas, Calif. Today his Westlake Village (Calif.) company generates over \$145 million a year in revenues—a fivefold increase over the past decade. Power, who owns a majority stake in the company, declines to reveal its earnings. But he says its car business is profitable, as are consumer-based ratings of telecommunications providers, homebuilders, and utilities. Just how much influence Power's opinions will have on number-crunchers isn't yet clear (page 160). Still, he hopes his au-

NOT JUST CARS

Power rates satellite dishes, hospitals—and now auditors

ditor ratings will become an annual rite. "That's how we want to grow—globally

and into nonautomotive areas," he says.

Whether the firm is rating sport-utility vehicles or cell-phone providers, Power tends to stick to a similar methodology. Take its best-known auto industry initial quality survey. Power mails out more than 100,000 surveys to recent car buyers, who are asked to report problems they encounter during their first three months of ownership. The results are ranked by complaints per 100 vehicles. Power releases highlights in free reports, but car makers who finish tops in various categories have to pay to advertise their rankings. Companies can buy more detailed survey results; they can also hire J.D. Power consultants to advise them on how to improve their scores.

PROMISE AND PITFALLS

A TOP RANKING from Power can have a profound impact. Hyundai Motor America saw sales of its Sonata jump 12% in the month after it was named the best entry-level midsize car, thanks in part to the Power mention in its ads. "We find people in focus groups bringing the J.D. Power name up spontaneously," says Chris Perry, national advertising manager at Hyundai.

Power's name hasn't always brought him fortune and adulation, however. Critics contend there's a conflict in selling consulting services to companies you also rate. Power counters that the companies seeking the consulting help are "the ones that have the problems." Last year he touched off a storm when he wrote an opinion piece for *The Wall Street Journal* blasting carmakers for sticking with an inflexible distribution system that he believes inflates car prices and prohibits dealers from selling many brands under one roof. Dealers protested. Ford Motor Co. later chose not to rehire Power for a dealer certification program. "It's primarily a business decision," says a spokeswoman for Ford.

Undeterred, Power continues to capitalize on his ubiquitous brand. To support the car surveys, the firm opened a Munich office in October. China and India branches will open next year. Power is seeking ways to fund the expansion with the help of investment banker Evercore Partners Inc. Rather than selling the company, Power says he would like an investment partner. Among the names bandied about is The McGraw-Hill Companies, parent of *BusinessWeek*. A McGraw-Hill spokesman says it is company policy not to com-

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Power learned the promise and the pitfalls of market research early in his career. After earning an MBA from the University of Pennsylvania in 1959, he went to work for Ford, General Motors, and tractor maker J.I. Case. He became disillusioned after watching managers rewrite his reports—in effect telling the top brass what they wanted to hear. In the mid-1960s he found a more receptive ear at chain saw maker McCulloch Motors Inc., which was having trouble cracking the consumer market. Power's research showed that the saws needed to be smaller, cheaper, and able to withstand months of idleness. McCulloch took his advice and sales soared.

BIO

James David Power III

From unremarkable beginnings, he forged a path to become the high priest of customer satisfaction:



BORN May 30, 1931, Worcester, Mass.

EDUCATION BA, English, College of the Holy Cross, 1953; MBA, University of Pennsylvania, 1959.

CURRENT POSITION Chairman, J.D. Power & Associates.

CAREER PATH Spent four years in the Coast Guard after college. Worked in market research at Ford, General Motors, tractor company J.I. Case, and chain-saw maker McCulloch Motors before founding his own firm in 1968. Business picked up after Power persuaded Shoichiro Toyoda,

the son of Toyota's founder, to hire him to study the U.S. forklift market.

WHEELS Drives a 2002 Mercury Marauder. So as not to play favorites, he picks cars that haven't won his company's trademark customer satisfaction awards. Past rides have included a Lincoln Continental and a Chevy Impala. He keeps each car for an average of seven years.

FAMILY Father to four children with first wife, Julie, who succumbed to multiple sclerosis in 2002. Married Joan, a former neighbor, late last year.

RANKLING WANKEL

IN 1968, POWER set off on his own. The persistent entrepreneur cold-called Toyota Motor Corp. several times before finally persuading the son of the company's founder to let him survey Toyota forklift buyers. Power's biggest break came in 1973, when Mazda Motor Corp. started hyping its new Wankel rotary engine. On a hunch, Power bought a list of Mazda owners from market researcher R.L. Polk & Co. and sent surveys to customers. Several respondents reported having major engine trouble. Power sold the report to other car-makers, one of whom leaked it to the press.

Soon other automotive giants called requesting Power's expertise, including Mazda's top U.S. executive, who invited Power in for a meeting. "I'd been trying to get to him for a year," Power recalls.

Even though he ceded day-to-day management to CEO Stephen C. Goodall, five years ago, Power is not slowing down. He often travels to industry events and client meetings, and is a popular guest lecturer at several business schools. A devoted family man, he spent years caring for his late wife, who succumbed to multiple sclerosis in 2002. She would often accompany him to auto industry events in her wheelchair.

"She was the chief," he says. "She put up good fight." Power remarried last year.

A list of Power's recent surveys show just how devoted the founder is to guiding his company's growth. There's the South Africa Initial Quality Study on cars, for example, and the Thailand Original Tire Customer Satisfaction report. Power vows that even if he brings in an investor, he'll stick around. After all, the man who preaches the importance of quality needs to make sure his own company maintains his high standards. ■

—By Christopher Palmeri in Westlake Village, Calif.

ACCOUNTING

Auditing the Auditors

In a world informed by the accounting scandals that engulfed Enron, Time Warner, Freddie Mac, and other formerly trusted giants, J.D. Power & Associates is now evaluating the very audit firms that are supposed to protect investors from such improprieties. And it's a report card no grade-schooler would want to take home to Mom and Dad.

Power surveyed nearly 2,000 chief financial officers and audit committee chairmen, asking them to rate auditing firms on 13 traits essential to reviewing the books properly. Among larger companies, Deloitte & Touche gets top marks, Ernst & Young comes

in second, and PricewaterhouseCoopers and KPMG are third and fourth. But even at No. 1, Deloitte can't exactly celebrate. Out of a possible 1,000 points, it got 734, or roughly a "C." KPMG, which ranked last of the big firms, barely passed with a 673. Among smaller companies with under \$1 billion in sales, Grant Thornton International and BDO Seidman LLP finished on top, with the smaller firms getting points for industry and company knowledge.

Most worrisome, only 44% of those



surveyed said they were "extremely" or "very" confident in the accounting profession, down from 53% last year. Ron Conlin, the J.D. Power partner who headed up the survey, blames the fact that auditors are expected to do more work these days to comply with Sarbanes-Oxley and are getting stretched too thin. Auditors reached for comment say they're committed to boosting quality.

Deloitte did well largely because its most senior personnel handle its largest clients, and its auditors have the deepest knowledge of each customer's business and industry. Conlin, who hopes to sell the report to the audit firms, says there is a strong correlation between auditors that clients say ask the toughest questions and those that got the highest scores. That sounds good, but how would Enron's CFO and audit chair have rated their auditor?

—By Nanette Byrnes in New York

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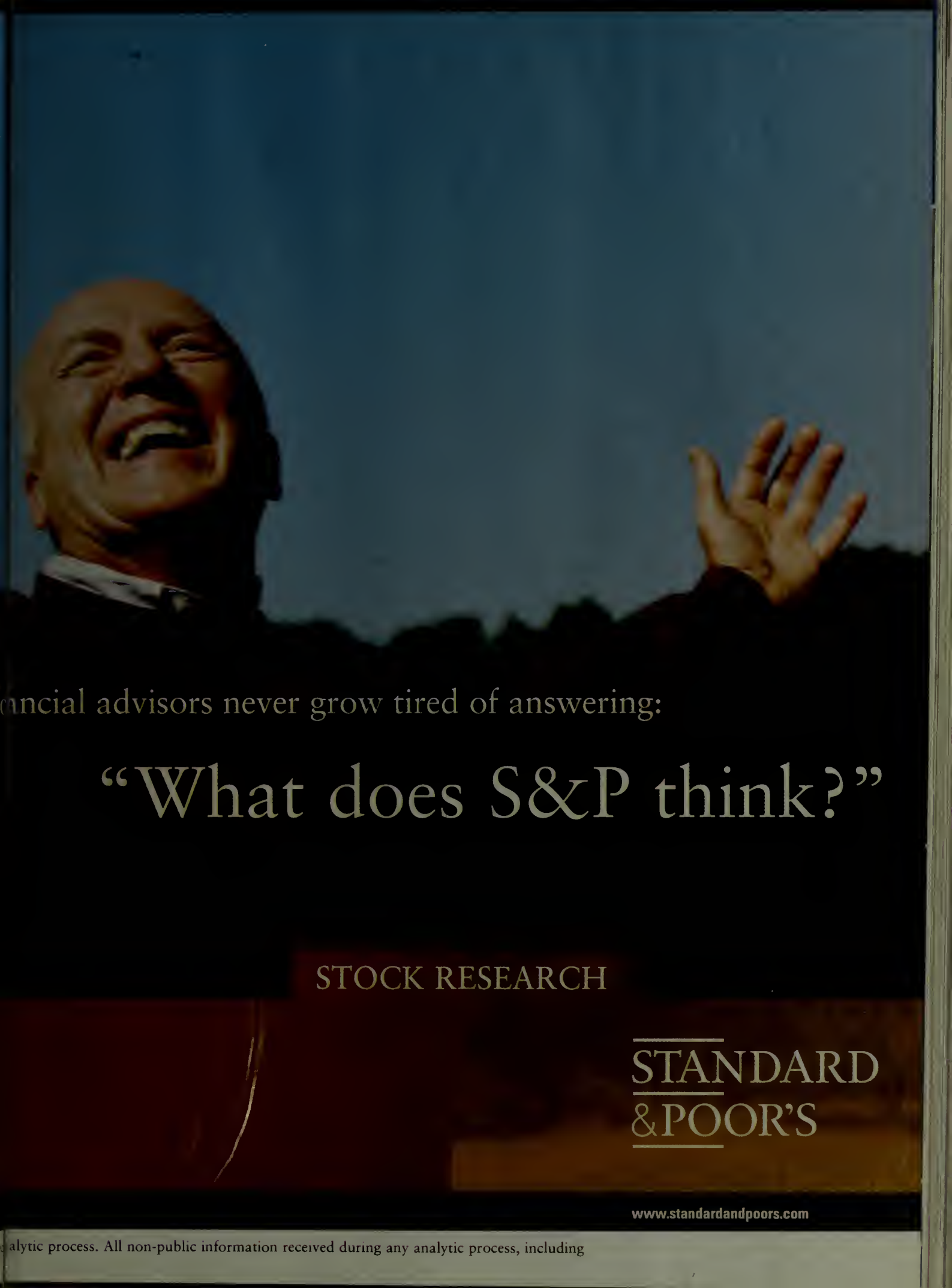
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A man in a dark suit is laughing heartily, his head tilted back and his right hand raised with fingers spread. The background is a clear blue sky.

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THE RISK AGENDA



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ONE DOES NOT NEED TO LOOK FAR TO REALIZE THAT WE LIVE IN A RISK-FILLED WORLD, ONE dramatically changed from years past. Even though the U.S. economy is rebounding, corporate scandals have moved off the front pages, and the United States has been safe from attack since the events of September 11, the last three years have reminded Americans, in an unforgettable way, that risk is an ever-present part of daily life. • Corporate executives clearly share this sentiment. In a September 2004 survey entitled "Security in the Workforce," sponsored by the mail services firm Pitney Bowes, nearly three-quarters of responding executives declared that enhanced corporate security (and hence the minimization of corporate risk) was either "extremely important" or "very important" to their organization. More than half said that the issue had grown to be of increasing concern to their company over the past 12 months. *(continued on next page)*

THE RISK AGENDA

Four Keys to Corporate Risk Management In An Unpredictable World

So vital has this issue become, in fact, that a new job title has emerged as one of the executive suite's most urgent: chief risk officer. According to a report in *BusinessWeek*, the position, hardly recognized in the years before 9/11, is now "one of the fastest growing in the upper ranks of Corporate America." And with good reason. Notes the magazine, "Fiascos such as Enron Corp. and WorldCom Inc. are a sharp reminder to boards and CEOs that handling risk—to a company's operations, market, credit standing, and reputation—is a top priority that can't be left to low-level employees." Quite simply, says the report, "what's at stake is a company's very survival."

Not to mention the corporate bank account. After declining an average of 6 percent since



Source: Insurance Information Institute. *First half of year

the mid-1990s, commercial property and casualty insurance rates rose 15 percent in the 12 months after 9/11. This trend has persisted. The most recent financial results report from the Insurance Information Institute (III), a national trade and advocacy organization, indicates that earned property and casualty

insurance premiums rose 11.5 percent in 2003, although they slowed to a 6.6 percent growth rate during the first half of this year.

In this situation, what can corporate executives—and the government policymakers who have so much influence on the large risk picture—do to promote a more stable, less costly operating environment for American corporations? Below, we address four topics that have emerged as among the most important.

WEB LINKS

Jefferson Wells: www.jeffersonwells.com

Reuters: www.reuters.com

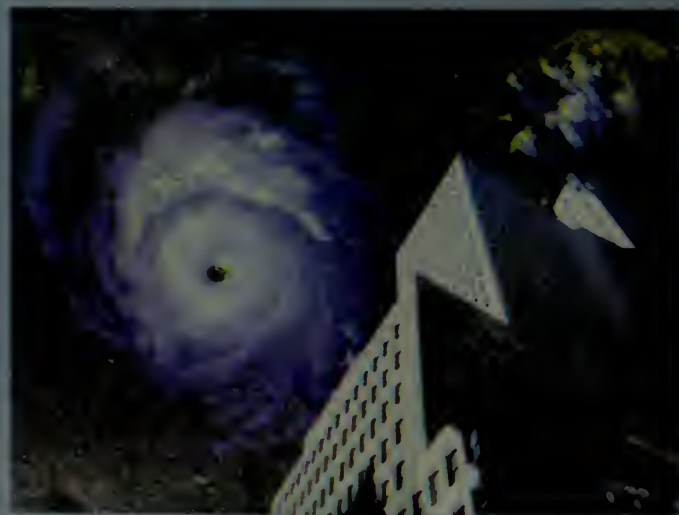
Swiss Re: www.swissre.com



1 Prepare for Catastrophes

Watching the news in recent months, it would be difficult to escape this fact: natural disasters are a predictable, if wrenching, part of modern life. Swiss Re, the international reinsurance company, notes in a report entitled "Natural Catastrophes and Reinsurance," that "Hurricane Andrew—a tropical cyclone that reached the highest level of the intensity scale—swept through the southeastern United States in 1992, leaving a trail of destruction... With total losses of some \$20 billion, Hurricane Andrew was the most expensive natural catastrophe of all time for the insurance industry."

This year, unfortunately, has not been much better. What the III refers to as "Florida's quartet of calamities"—Hurricanes



"In spite of huge annual fluctuations, a clear trend emerges," namely, "that insurance losses caused by natural catastrophes have risen dramatically."

SWISS RE'S SIGMA CATASTROPHE DATABASE

Charley, Frances, Ivan, and Jeanne—"left insurers with a tab estimated at somewhere between \$22 and \$27 billion," effectively wiping out the industry's after-tax profit of \$23.5 billion during the first half of 2004. This is money that insurers, in some measure, will obviously need to recoup, either through still higher insurance premiums or reductions in coverage.

And matters are likely to worsen. Analysis of Swiss Re's sigma catastrophe database over the past 30 years indicates that, "in spite of huge annual fluctuations, a clear trend emerges," namely, "that insurance losses caused by natural catastrophes have risen dramatically." This increase results from both higher population densities and a greater frequency and intensity of certain natural catastrophes—trends that the company forecasts will persist in coming years.

BOTTOM LINE

Recognize that property and casualty insurance rates are likely to continue rising over the long-term and budget accordingly.



Judith Klugman, Insurance-Linked Securities Expert, Swiss Re

Natural catastrophes can cause losses of incomparable magnitude. "Such risks can be transferred to the capital markets through insurance-linked securities." Judith Klugman points out their benefits for both sponsors – attractively priced catastrophe protection over a multi-year term without exposure to counterparty credit risks – and investors, who welcome their risk-return profile and the fact that they diversify portfolio risk. Offering a combination of expertise and financial strength, Swiss Re is ideally positioned to provide your company with tailored solutions to mitigate your catastrophe exposure and protect your balance sheet – so when the elements start raging, you can keep your calm. www.swissre.com

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THE RISK AGENDA

Four Keys to Corporate Risk Management In An Unpredictable World

2 Ensure Network Security

The damaging effects of computer-based crimes like computer viruses, denial-of-service attacks, and thefts of data are well-known, as are accidental interruptions of business operations due to computer system malfunctions. For example, one survey, by American International Group's eBusiness Risk Solutions, determined that computer viruses alone caused an estimated \$13 billion in damage in 2001.

Despite these serious conse-



Computer viruses alone caused an estimated \$13 billion in damage in 2001.

AMERICAN INTERNATIONAL GROUP'S EBUSINESS RISK SOLUTIONS

quences, says the III, "Corporate America has been slow to come to terms with this new reality." The 2003 Ernst & Young "Global Information Security Survey," for instance, "found that 90 percent of 1,400 organizations surveyed recognize that information security is of high importance and 78 percent identify risk reduction as the major influence on their information security spending." Yet, in spite of this concern, one-third of organizations say that their ability to determine if their systems are under attack, and to respond to such attacks, is less than

adequate. Two-thirds say that they are not compliant with applicable security regulations.

Fortunately, there are effective ways of minimizing the risk from IT-related catastrophes like these, as well as from their consequent business interruptions. One is to undertake the necessary preventive measures. The Pitney Bowes study, referred to previously, observed that one of the most critical factors in improving corporate IT security was the regular conduct of a formal enterprise-wide security audit. As compared to other firms, companies that had undertaken such an audit: were half again as likely, by a margin of 52 percent to 32 percent, to have increased their corporate security spending; were twice as likely to have improved their risk assessment capabilities; and were more than twice as likely, by a margin of 68 percent to 32 percent, to have put a business continuity plan into place.

Of course, even with sophisticated security plans, not all IT risk can be eliminated. But it still can be managed. The III notes that "network security insurance, more widely known by names such as cyber insurance and hackers insurance, has been in existence only since the 1990s." Still, the market has matured to the point that such coverage is available, usually in the form of standalone policies, to indemnify against such events as loss or corruption of data, business interruption, and financial or other liability.

BOTTOM LINE

Make an enterprise-wide commitment to network security a top priority, not just in words but in deed, while insuring against inevitable system failures.

3 Manage Enterprise Financial Risk

Legislation to stem runaway tort liability costs may have stalled, but Congress did respond quickly to public outcries against the accounting abuses that felled such firms as Enron, WorldCom, and Arthur Andersen. The resulting law, officially known as the Public Company Accounting Reform and Investor Protection Act but more commonly referred to, after its sponsors, as Sarbanes-Oxley, has now become a routine part of every CEO's and corporate risk manager's lexicon.

And, as well, part of their budget. Despite the law's obvious benefits and much-needed protections for investors, rarely has there been a case where so many have had to pay so much for the sins of so few. The Hackett Group, a Atlanta-based business advisory firm, estimates that the annual cost of complying with Sarbanes-Oxley will range from \$5 million to \$10 million for most public companies. That's hardly a trivial sum. As Robert Edwards, vice president and chief information officer for commercial real estate developer The Rouse Company, recently remarked to eWeek, "If you have to pour up [even] \$1 million a year in ongoing compliance costs, and you're making only \$100 million a year, that's a lot of money to spend on a non-revenue-generating activity."

Minimizing these compliance costs, as well as a company's ultimate risk exposure, requires that companies undertake the equivalent of an IT security audit, like that referenced above, for their financial operations. Jefferson Wells, a global provider of accounting and finance-related services designed to help corporations to better manage risk, calls this procedure an "enterprise financial risk assessment." Such an assessment "is an audit approach that identifies, measures, and prioritizes risks so that audit resources are used to address auditable areas of greatest significance, and provides a means of allocating resources to more effectively meet the auditing needs of the organization, based on financial risk, probability of error, and impact of errors resulting from business risk."

Sarbanes-Oxley compliance, however, involves more than warding off financial liability. "There are strong business reasons for companies to do more than just take a 'check-the-box' approach," says Dan Langer, head of Jefferson Wells' internal audit practice. "By being proactive and truly embracing



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Four Keys to Corporate Risk Management In An Unpredictable World

the spirit of the new law, companies can reap direct benefits that more than justify the time and cost of their compliance efforts." The most important benefit: restoring trust. A July 2002 survey conducted by McKinsey & Co. found that more than 75 percent of surveyed investors would pay a premium for companies that were well-governed.

BOTTOM LINE

Minimize financial risks through a systematic enterprise financial risk assessment and restore trust by aggressively complying with the spirit of the new investor protections.

4 Guard Against Liability Risks

A prominent point of contention in the recent Presidential campaign was the adverse impact of medical liability expenses on the cost and availability of health care in the United States. But medicine is only the tip of the liability iceberg. As a recent white paper, "Tort Excess 2004," sponsored by the U.S. Chamber of Commerce, makes clear, "The United States has the world's most expensive tort system. America's civil justice system costs more than double that of other industrialized nations." Indeed, "the cost of the U.S. tort system increased 13.3 percent to \$233 billion in 2002," representing 2.2 percent of the U.S. gross domestic product. "This brings the tort cost increase through 2001 and 2002 to \$27.4 billion—the largest two-year increase in U.S. history."

The U.S. Chamber-sponsored study asserts that "there are two possible remedies for the problems riddling U.S. civil justice." The first, the study says, is legislative tort reform at both the state and federal levels. Yet, "for those advocating such reforms, 2003 was among the most disappointing years on record. Three much-anticipated federal reforms were left on the table, including bills intended to halt class action abuse, reform (and cap) compensation in medical malpractice lawsuits, and bring some finality to asbestos litigation." Likewise, in 2004, two major bills addressing liability concerns failed to clear the Congress.

Richard Edelman, president and chief executive officer of Edelman, the world's largest public relations firm, observes in *Global Agenda* magazine that, "these days, proper corporate risk management calls for true involvement in the issues of the day and a strong voice to assure the company's interests are served." This



principle applies nowhere more plainly than it does in the area of tort liability reform. Political action is obviously required to curb tort abuses, and the necessary political action is likely to come about only with intense and continuing advocacy on the part of the business community.

Until such reform takes place, says the U.S. Chamber-sponsored study, Corporate America's primary recourse against growing liability

costs "is sound risk management via a strong, tall tower of liability insurance. Such insurance must be viable and its underwriter able to pay defense costs, settlements, and judgments in possibly catastrophic liability claims that may occur many years after the initial policy is purchased." The study concedes that, in the current insurance marketplace, "securing a strong, tall tower of insurance is often easier said than done."

Still, the desired result can be achieved when risk managers focus on four key areas: (1) securing ample limits; (2) demanding the highest degree of financial strength possible from their insurer; (3) ensuring that the carrier has the underwriting experience to withstand the inevitable volatility of casualty underwriting; and (4) carefully evaluating the carrier's internal expertise and external resources in defending against claims and in mitigating losses.

BOTTOM LINE

Continue fighting for meaningful tort liability reform while taking commonsense steps to protect against possibly catastrophic liability claims.

Putting Risk into Perspective

Risks are an unavoidable, even increasing aspect of corporate life. But that does not mean that they have to be debilitating. As John Smutniak points out in *The Economist*, "risk is different from uncertainty, which is unquantifiable." Enhancements in computing capabilities have made it far easier than ever before to project the likelihood and costs, in a statistical sense, of such unpredictable events as natural disasters and financial catastrophes—and markets have matured to the point that most such risks now can be shifted "from a party that does not want to bear them to one that does."

To be sure, the burden of risk management on corporate leaders is

greater now than it has been in the past. That said, it's also true that running a business has never been easy. Even before computing networks, corporate scandals, or random acts of destruction became such prominent features of our daily lives, prudent business leaders relied on common sense, preventive thinking, and wise business advisers to minimize the risk to their organizations. The good news is: they can continue to do the very same thing today.

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Showtime For Your Home

Stagers can give your dwelling a makeover to help it bring top dollar. **BY ANNE TERGESEN**



WHEN THE SALE OF HIS three-bedroom apartment on Manhattan's Upper West Side fell through in mid-2002, Tom Allon decided to stay put. Good thing, because this June the president of magazine publisher Manhattan Media received an offer that exceeded his "wildest expectation," topping his original asking price by some 45%. The appreciation of New York City real estate played a role in Allon's good fortune, but it's not the whole story. Also working in his favor was a \$10,000 makeover conducted by one of a growing number of "stagers," or designers who prepare homes for sale. Allon's stager devoted most of

his budget to the kitchen, since it's visible upon entering the apartment. She replaced formica countertops with Corian and repainted yellow cabinets a neutral white. She put new linens, pillows, and shams in the master bedroom, regouted the master bath, and bought a purple shower curtain and coordinated rug for the kids' bath to draw the eye away from older fixtures. "The apartment looked so

great I almost decided to stay," says Allon, whose five-person family has outgrown the 1,700-square-foot residence.

These days it's not enough simply to clean the house before putting it on the market. To net top dollar, you have to banish most traces of yourself—from your refrigerator magnets to your kids' artwork—and create an idealized living space, almost with the look of a model home. The goal is to show potential buyers a dwelling that's both tasteful and impersonal enough to allow them "to mentally move in," says Barb Schwarz, a

Whidbey Island (Wash.) Realtor who founded the International Association of Home Staging Professionals.

Although stagers sometimes remodel, they usually work with what's already there. They rearrange furniture to point the eye to a home's strongest features, such as an architectural flourish or beautiful view. To create a sense of spaciousness, they declutter—relegating the contents of countertops, closets, and bookshelves to storage. To dress up tired kitchens and outdated bathrooms, they buy accessories, such as area rugs and framed prints. To add warmth, they install light fixtures and repaint walls in warm, neutral tones. Some even remove your furniture and rent replacements.

The cost varies, depending on the site location, and condition of your home. Some stagers, including Allon's, are Realtors who do this for free, as a service to clients. Others charge \$75 to \$100 an hour on average. Regardless, you'll pay extra for the accessories they buy or the cleaners, painters, or landscapers they recommend. To ready a small condo for the market costs an average of \$500 to \$1,000, including both the stager's fee and materials, Schwarz says. The tab for a home that's 4,000 square feet or more

For before and after pictures of staged homes, go to www.businessweek.com/magazine/extra.htm

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AFTER



BEFORE

● An airy glass coffee table takes the place of two heavy wooden tables. The plant that was on top of the wall unit is more visible on the table. ❷ To eliminate clutter, some photos and knickknacks are gone from the wall unit and the doors are closed. ❸ A new lamp adds warmth. ❹ Removing a sofa section opens up the room and better unites it with the hall.

Barb Schwarz, International Association of Home Staging Professionals

can easily exceed \$2,500. In more expensive markets, such as Manhattan and Silicon Valley, real estate pros quote prices of up to \$40,000. One way to cut costs: Hire a stager to draw up a plan of action for a couple hundred dollars, and do much of the work yourself.

Realtors say staged homes net higher prices and sit on the market for less time than unstaged ones. Joy Valentine, a broker at Coldwell Banker in Los Altos, Calif., looked at 3,358 homes sold in the San Francisco Bay area from Jan. 1, 2002, to Oct. 31, 2002. In general, the staged homes went for the asking price and spent 25.3 days on the market, vs. 2% below asking and 48.2 days for the group.

Homeowners who've hired stagers say it's helpful to have an objective person identify flaws. But if you feel you have a good eye and want to do your own staging, professionals offer these tips:

» **Start outside.** Cross the street and take a hard look at the first impression your home makes. If the trees and bushes are overgrown, trim them. Clean the windows. Not only will this convey tidiness, it will let in more light. Paint the front door and polish your street number, door knocker, and mailbox.

» **Stand in doorways.** That way, you'll see what potential buyers see before entering the rooms. Any time you make a change, go back to the door to assess.

» **Declutter.** Remove most photos and knickknacks, since they can distract buyers. Clear your kitchen and bathroom counters and store cosmetics and appliances. Organize cabinets and closets to impress snoopers with how clean and orderly your home is. Remove bulky or excess furniture to open up rooms. "You have to move, so we pack you early," says Schwarz.

» **Let in the light.** Take down heavy or layered drapes and raise the blinds. Clean fixtures or buy new ones and keep the lights on while showing the house.

» **Keep the colors tame.** Repaint in warm, neutral colors to make sure nothing clashes with a buyer's furniture. But stay away from white with gray undertones, since gray lacks warmth. Add punch with brightly colored accessories and live plants. "We're the Pottery Barn generation. Since that's what sells, bring in elements of that style," says Deanna Kory, Allon's stager and a Realtor at The Corcoran Group in New York.

» **Return rooms to their proper functions.** Buyers won't have to strain to imagine your home office as, say, a dining room. ■

Getting a Better Fix on Glaucoma

A \$50 pachymetry test improves diagnosis of the disease. **BY CAROL MARIE CROPPER**

FOR DECADES, OPHTHALMOLOGISTS have relied on a simple test called tonometry to check for high pressure inside the eye, often an early warning of glaucoma. Many patients know it as the “air puff” test, although it has been replaced in many offices by a puffless version. But now, ophthalmologists such as Lorin Press in Edison, N.J., are saying that without a second test, called pachymetry, to measure corneal thickness, they can miss someone at risk for glaucoma. Trouble is, most insurers won’t cover pachymetry unless the patient is already known to have—or suspected of having—the disease. So Press doesn’t test most of his patients.

All this may change in a few years as more studies establish the importance of pachymetry, which uses ultrasonic waves to measure the thickness of the transpar-

ent tissue covering the iris and pupil. Until then, pachymetry will remain another case where patients may have to take matters into their own hands, asking for the two-minute, painless test by name and agreeing to pay the \$50-or-so cost if their insurer won’t.

SKEWING RESULTS

PATIENTS WITH HIGH intraocular pressure (IOP) are more likely to develop glaucoma, which afflicts about 2.5 million Americans, damages the optic nerve, and blinds tens of thousands. Ophthalmologists have long known that an unusually thin or thick cornea can skew results from the pressure test. Just as it takes less pressure to indent a balloon than an automobile tire—regardless of the air pressure inside—a thinner cornea is more easily pushed in, tricking the tonometer into registering a lower pressure. A patient with a thin cornea may seem to have nor-

mal eye pressure even if it’s high. Conversely, one with a thick cornea may have a high reading, leading an ophthalmologist to treat a problem that may not exist.

QUICK The pachymeter gauges corneal thickness

What many ophthalmologists didn’t know until recent years is just how much corneal thicknesses vary. That means the risk of a false IOP reading is higher than previously thought. In addition, new surgical procedures are creating patients with a greater risk of a false tonometry reading. Those who undergo laser surgery to correct their vision typically wind up with thinner corneas and are therefore more likely to test low, meaning problem pressure might be missed, says Dr. James Brandt, director of the glaucoma service at the University of California at Davis and one of the researchers in a landmark study on treating patients with high IOP.

That multicenter study, funded by the National Institutes of Health and reported in the *Archives of Ophthalmology* in 2002, shows that corneal thickness itself can be a powerful predictor of glaucoma. The study found that in patients already considered at risk because of high IOP, those with the thinnest corneas were three times as likely to develop glaucoma as those with thick corneas.

Because the study didn’t include subjects drawn from the general population, the American Academy of Ophthalmology hasn’t called for broad pachymetry testing, says Dr. Joel Schuman, chairman of the ophthalmology department at the University of Pittsburgh School of Medicine and a spokesman for the AAO. “The Academy is conservative in the recommendations that it makes,” he says. “Without having the hard evidence, it’s harder to recommend the test that broadly.” In his practice, Dr. Schuman says he tests everyone because he believes it’s important to do so. Glaucoma can be treated with medication, laser treatments, surgery, but vision lost before the disease is discovered cannot be restored.

That’s why spotting a problem before the damage is done is crucial. So next time you go for an eye exam, take the extra \$50 you had planned to spend on designer frames and pay for a pachymetry test instead. You might not look as stylish, but you could wind up seeing better. ■

REGULAR TEST The tonometer checks the pressure inside the eye





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If Your Brokerage Goes Broke

How solid is coverage for losses over \$500,000? **BY TODDI GUTNER**

IN THE EVENT OF A CATASTROPHIC firm failure, can major brokerage companies really deliver on their promise to insure the cash and securities in their customers' accounts? That's a question for clients of the 14 firms that a year ago organized a captive insurer called Customer Asset Protection Co. CAPCO's mission is to provide virtually unlimited coverage above the \$500,000 per account offered by Securities Investor Protection Corp. (SIPC).

According to CAPCO's Web site, "there is no specific dollar limit to the protection that CAPCO offers on customer accounts." But if you want to know what the financial backing is for that coverage, you won't get very far. "That's proprietary

information," says CAPCO President Frank Lagerstedt. *BusinessWeek* tried to ferret out this information by analyzing more than 50 Securities & Exchange Commission (SEC) quarterly 10Q and annual 10K documents of CAPCO members. We did come up with an estimate of the insurer's initial capitalization. But that provides only a partial picture of CAPCO's resources at best.

Before CAPCO, brokerages used to buy unlimited excess coverage (also known as full-net-equity protection) from Travelers Property Casualty, Radian Asset Assurance, and American International Group. That insurance was intended to compensate customers for missing cash and securities as a result of firm failure—not investment losses—beyond the

amount that SIPC covers. Then, despite racking up millions in premiums and never paying a claim, those insurers left the business in August, 2003, because, say industry experts, they couldn't quantify their potential liability from a brokerage firm failure.

To replace the excess coverage they had lost, 14 brokerages formed CAPCO. Others, including Charles Schwab, Merrill Lynch, and UBS Financial Services, declined to join the consortium. Spokespeople for Merrill and UBS say other options were better for their clients than CAPCO. Robert Meave, an insurance consultant at Schwab, says: "We weren't comfortable telling clients: 'You have unlimited insurance coverage—and by the way, we're founders of the insurance company.'"

Merrill and Schwab went to Lloyd's of London for excess SIPC coverage. Lloyd's insures \$150 million per customer, but more than a total of \$600 million per broker-dealer. UBS turned to XL Insurance (Bermuda) Ltd., which also has a \$600 million cap (table, page 178).

When companies say they have virtually unlimited insurance coverage, you'd expect them to provide proof that they can support the potential liability. In other words, "show me the money," says Robert Poyourow, a senior vice-president at AON, the insurance broker that structured the XL policy for UBS Financial Services.

LEGALLY TIGHT LID

LAGERSTEDT SAYS CAPCO doesn't need to divulge its capitalization and other financial information to the public. He says CAPCO provided that data to Standard & Poor's before S&P gave the insurer an A rating last December. "CAPCO's rating was considered strong because the likelihood of a material loss is very low," says Jas Jones, the S&P analyst who evaluated CAPCO. (S&P, like *BusinessWeek*, is owned by The McGraw-Hill Companies.)

Lagerstedt has legal backing for withholding the information, as *BusinessWeek* recently discovered after the New York State Insurance Dept. denied our Freedom of Information Act request.



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dom of Information Act (FOIA) request for CAPCO's financial information. Under New York Insurance Law, Section 7003(c) (3), the information filed by a captive insurer in its application for licensing is "given confidential treatment and shall not be subject to public inspection...except to the extent the superintendent finds release of information necessary to protect the public...."

After the FOIA request was denied, *BusinessWeek* was able to estimate that CAPCO had an initial capitalization of \$75.6 million. We pieced this together by reviewing more than 50 financial documents of CAPCO member firms. One member reported in its 10Q that it invested \$5.4 million. Since CAPCO has disclosed that each member owns equal shares, we multiplied \$5.4 million by 14, for a total of \$75.6 million.

MARKETING GLOSS?

EVEN KNOWING THIS, it's impossible to assess CAPCO's complete financial picture. First, each member must pay a yearly premium for its CAPCO coverage. CAPCO, in turn, may buy reinsurance to cover a portion of its future liabilities. We don't know how much reinsurance CAPCO has or how much of the member premiums go to boosting the company's capital. CAPCO also won't say whether member firms are required to ante up additional capital if a large claim drains its resources.

Of course, as long as CAPCO doesn't have to pay a claim, the company's finan-

Who's Insuring Whom?	
The Securities Investors Protection Corp. (SIPC) insures retail brokerage accounts for up to \$500,000 each in the event of a firm failure. To cover losses beyond that, brokers have arrangements with the following insurers:	
CAPCO	A captive insurer of 14 brokerages that says it has no dollar limit on excess SIPC coverage
Member firms	Robert W. Baird, Bear Stearns, Credit Suisse First Boston, A.G. Edwards, Goldman Sachs, Edward Jones, Legg Mason Wood Walker, Lehman Brothers, J.P. Morgan Chase, Morgan Stanley, National Financial Services (Fidelity Investments), Pershing (Bank of New York), Raymond James Financial, and Wachovia Securities
LLOYD'S OF LONDON	Offers \$150 million per customer but no more than a total of \$600 million per broker-dealer for customer losses
Client firms	Ameritrade, E*Trade, Merrill Lynch, Charles Schwab, Smith Barney/Citigroup, T.D. Waterhouse
XL INSURANCE	Insures for up to \$600 million in total customer losses
Client firm	UBS Financial Services

cial backing doesn't come into play. In fact, the need for excess SIPC coverage has been minimal in the past. Since 1970, SIPC has paid claims to 623,000 brokerage clients. Only 311 of those clients had losses beyond what SIPC provided. The total excess coverage was \$40 million—and \$10 million went to one client alone. "Most of those claims arose prior to 1980, when SIPC covered only \$50,000, not the \$500,000 limit it is today," says Stephen Harbeck, president of SIPC.

That history leads some in the industry to say that excess SIPC coverage is little more than a marketing tool for broker-

ages that say they offer it. "We buy insurance for the sleep-at-night factor, and excess SIPC has always been a nice enhancement for clients," says Schwab consultant, Meave. "You had it because your competitors had it." Rather than consider the amount of excess SIPC coverage a firm carries, says Meave, an investor should place more emphasis on financial strength.

Still, if brokerages are going to use limited excess SIPC coverage as a selling point, don't they owe their customers a better explanation of how they intend to provide it? ■

Benefits

Time to Empty That Piggybank

Use it or lose it. That's the mantra those with flexible spending accounts (FSAs) should be repeating to themselves as the year winds down. An FSA allows you to set aside up to \$5,000 in pretax dollars to pay for medical expenses not covered by your

company's regular health-insurance plan.

The catch is that once you agree to contribute a certain amount, you have to use it up by the end of the benefit year or forfeit the remaining funds to your employer. According to a recent study of 1,084 employees at major corporations by Richard Day Research on behalf of Fidelity Investments, 91% of FSA users spent the full amount in their accounts last year. Of those who didn't, a third reported leaving less than \$100.

If you're still facing a big balance in your account, here are some ways you can eat up the surplus:

■ **Remember your copays and deductibles.** The fixed amounts you have to pay for doctors' visits and prescriptions qualify as FSA expenses, as does what you spend out-of-pocket before your

out-of-network coverage kicks in.

■ **Stockpile over-the-counter medications.** As of this year, you can get reimbursement for everything from aspirin to cough syrup. Check with your plan administrator to see what's covered. Of course, don't forget to submit your prescription drug receipts as well.

■ **Take care of your eyes.** In addition to an eye exam and prescription glasses, your FSA will cover vision-correction surgery and eye drops. You can also stock up on disposable contact lenses.

■ **Visit your dentist.** Have an extra cleaning, get those braces you've been considering, or buy dental supplies, such as teeth-whitening cream.

■ **Seek preventive care.** Get a flu shot (if you can find one) or have your cholesterol checked.

—Todd Gutner

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Not Your Mom's Holiday Turkey

More Americans are discovering pheasant, duck, and heritage breeds.

BY AMY CORTESE



FEW FOOD TRADITIONS are as rooted in our culture as Thanksgiving turkey. But as Americans continue their love affair with fine food, the more discerning are venturing beyond the big mass-produced white birds that have dominated holiday tables for decades. Some are serving up game birds, such as duck, goose, and pheasant. Others who aren't quite ready to give up turkey are buying rare heritage breeds, such as Bourbon Reds, Jersey Buffs, and Narragansetts, with bloodlines that are centuries old.

What's driving the trend? Chefs and foodies say game birds and heritage turkeys simply taste better. David Rosengarten, editor of *The Rosengarten Report* on

food and wine, suspects that many folks don't even like regular turkey meat all that much. Raised in pens, fattened with special high-protein diets, and dosed with antibiotics, the broad-breasted whites found in most supermarkets and at most family gatherings tend to be bland—even with all the basting, brining, stuffing, and frying home cooks use to eke out flavor and moistness.

Heritage breeds and game birds, on the other hand, feed on diverse, natural sources of food, such as grass and insects. Those raised on farms are given more time to mature and the ability to roam about and be active. Heritage turkeys, un-

like their modern brethren, can actually fly. All of those factors give these birds more muscle and firmer, leaner meat, as well as a richer and more complex flavor. (It also makes them more expensive: Heritage turkeys fetch up to \$4 a pound, a goose and duck run around \$6 a pound while store-bought, mass-produced turkeys cost just 40¢ a pound or less. "Once you get to know and like the taste, it's hard to go back," says Th. Schoenegger, executive chef at Patina restaurant in Los Angeles that features a game menu every autumn.

For some Americans who grew up with different cultural influences or who live

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urts of the country where hunting is popular, game birds are familiar fare. Mark Orfaly, the chef at Pigalle, a restaurant in Boston, says his Armenian grandmother often prepared duck or goose for the family's Thanksgiving feast. "I liked that more than turkey," he says. Orfaly cautions, though, that those birds require "a little more than basic cooking skills."

Indeed, the thought of roasting a goose, pheasant, or guinea hen can cause trepidation even in experienced cooks. Most of those birds are lean, so they're easy to overcook. Experts suggest cooking them at higher temperatures for shorter periods to seal in the juice. They also can be topped with bacon or pancetta to add fat. In contrast, duck and goose can be fatty and are best cooked slowly to achieve moist meat and crisp skin.

CAJUN NOVELTY

IF YOU'RE PLANNING for a large gathering, goose and capon can be quite big—up to 12 or so pounds. That's tough to feed at least six. Duck, pheasant, and other birds typically are smaller, which makes them practical for more intimate groups. Another option if you're feeling especially adventurous (or indecisive) is a Cajun novelty called turducken. It's a stuffed, boneless chicken inside a boneless duck, which is then stuffed within a turkey. The tasty package typically weighs 15 pounds to 16 pounds and can cost \$120 or more.

Over the past few years the alternatives to typical turkey have become more readily available (table). You can find heritage breeds and wild game birds at many local farmers' markets and in gourmet or organic retail stores. Artagnan, a Newark (N.J.) purveyor of fine foods, offers a wide selection of wild and naturally raised game and poultry in retail stores as well as online at artagnan.com. The site includes cooking instructions and recipes. The birds are delivered fresh via FedEx or UPS for \$25 per order, or free for orders over \$250.

Choose any of these alternative birds for Thanksgiving, and you may be starting a new tradition for your family. ■

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ckoryfarms.com; 800 442-7171; Turducken and other food products

LOCALHARVEST

localharvest.org; Heritage turkeys, poultry, and game birds

What to Pour For Turkey Day

Red or white doesn't matter, but finding a match for those side dishes can get tricky. **BY AMY CORTESE**

THE TURKEY IS ORDERED; the menu is set. Now what to wash it all down with? Choosing wine for the annual Thanksgiving feast can be vexing. Turkey is about as versatile a main course as you could hope for, pairing well with both red and white wines. But when it comes to cranberry sauce, sugary yams, and other side dishes, things get more complicated. The tart or sweet nature of some accompaniments can clash with wines that may be perfect for the rest of the meal.

LET THE FOOD SHINE

SOME GENERAL RULES can help. Don't get hung up on red vs. white. It's more important to choose wine that's not too heavy and won't overpower the food you spent all day preparing. So go for medium-bodied wines: Pinot noir is especially versatile. Calera makes a Burgundy-style pinot noir from California, a great value at \$14.95, says Roberta Morrell of wine merchant Morrell in New York. Any young and fruity red, such as a Beaujolais or Rioja, is a good all-around choice.

For white, Morrell suggests something "meaty," such as a Châteauneuf du Pape. Some wonderfully rich whites have a minerally, herbaceous edge that can cut through the cacophony of flavors on the table. Try a Pouilly Fumé—La Duccette makes a nice one for \$23.95—or a Savennières, pro-

duced from the chenin blanc grape.

If you're serving a heritage turkey or a game bird such as duck or goose, you can go for a more full-bodied wine. These flavorful fowl hold their own with a syrah, Barolo, or zinfandel. Or check out River Wild Winery's Turkey Blend (\$14). A mix of zinfandel, grenache, and petit syrah, it's one of four blends created by the winery to complement wild game. For more delicately flavored fowl, such as pheasant, opt for an equally subtle wine, such as a light red from Burgundy.

The best strategy for side dishes is to either mirror or contrast the main flavors. Yams would be well served by a sweet, crisp German reisling. A tart, acidic cranberry dressing would go well with a wine whose acidity stands up to it, such as a Cabernet Franc from the Chinon region of the Loire Valley.

Then don't fret. Just enjoy the meal. ■



TOP PICKS Savvy choices might include a rich white, a blend of reds created specifically for heartier fowl, or a Burgundy-style pinot noir

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EDITED BY TODDI GUTNER



HEALTH

Liquid Smarts?

MEMBER THOSE high school health class warnings about alcohol killing your brain cells? A recent study by researchers at **University College London** issues a glass to those who didn't take the pronouncement too seriously. It found that middle-aged people who think have better cognitive function than those who don't. The study, published in the **American Journal of Epidemiology**, followed 6,000 London government workers for 11 years, recording their alcohol consumption, then testing five measures of cognitive function, including vocabulary and deductive reasoning. Drinkers were about half as likely to score in the lowest quintile.

Dr. David Knopman, a neurologist at the **Mayo Clinic** in Rochester, Minn., isn't surprised by the British group's findings. Drinking is generally seen as positive health behavior unless it's excessive, he says. Alcohol's accepted ability to reduce the risk of cardiovascular disease and atherosclerosis may translate into better cognitive function by reducing arterial plaque and strokes, he says. However, Knopman is quick to point out that the study found only an association between drinking and better mental performance—not a causal relationship. People who drink could just be smarter and better educated than teetotalers, he says.

—Carol Marie Cropper

EDUCATION

A PRICE BREAK IN COLLEGE SAVINGS PLANS

COLLEGE JUST keeps getting more expensive. But for investors in 529 college savings plans, there's heartening news on the fee front. Index-fund giant **Vanguard**—already a low-cost provider—cut costs on six options in its Nevada-sponsored **529 College Savings Plan**, which is marketed nationwide. Most fund expense ratios are now 0.65%, a 10% to 16% cut. Vanguard says that with assets at \$650 million after two years, it can pass along economies of scale. Expenses on its \$2.9 billion New York plan will fall when it reaches \$4 billion.

Will other 529 plans follow suit? Until the industry adopts a standardized fee schedule to aid in plan comparisons,



don't bank on it, says Mercer Bullard, who's president of advocacy group Fund Democracy.

—Suzanne Woolley

GIFTS

With \$5 billion worth of gift wrap tossed in the trash each year, reusable gift bags may be an idea whose time has come. **Wrapsacks** (\$3 to \$8 at wrapsacks.com) are **hand-dyed cotton bags designed to be recycled**: Receive a gift in one, use it to give a gift to someone else. Each comes with a unique ID sewn inside. If all recipients enter the bag's whereabouts at the Web site, you can track its travels.



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BY ROBERT BARKER

Three Promising Stocks For Taxing Times

Well before Election Day, review copies of 2005 tax guides began piling up on my desk. Publishers didn't need to know which way Ohio went to know that confusion, annoyance, and despair over changing tax rules are permanent engines of the U.S. economy by driving sales of tax books and tax advice, not to mention investments that avoid taxes.

President George W. Bush is vowing to make permanent his first-term tax cuts and overhaul the Internal Revenue Code. Yet it's hardly a stretch to suggest that taxpayers will keep seeking ways to lower their tax bills. Even as the President renews his oath of office in January, the Treasury will be embarking on record-high quarterly sales of the bills, notes, and bonds it must float to finance this year's budget gap. So you can safely bet that pressure to find revenue will remain intense. That's why there's still promise in any company offering advice on how to avoid taxes or selling such specialized financial products as "tax-aware" mutual funds. With that in mind, I've been focusing on a trio of public companies (table):

» **Eaton Vance.** This Boston-based investment manager has long marketed its mutual funds and advisory services by focusing on total, after-tax investor returns. For example, the company offers a host of municipal-bond funds aimed at investors threatened by the alternative minimum tax, plus stock funds that are managed to minimize taxable



distributions. It has been a winning strategy for Eaton Vance. Not including those picked up in acquisitions, assets grew 35% during the past three years. In the fiscal year ended on Oct. 31, Wall Street estimates that earnings per share grew almost 30%, to \$1.97. Eaton Vance has nearly three times as much in cash and short-term investments as it does debt.

» **Nuveen Investments.** Nuveen once focused so purely on municipal bonds that the Nuveen name became synonymous with tax-exempt. That has changed markedly with the addition of such stock-picking firms as \$10 billion-in-assets Rittenhouse, which the Chicago company bought in 1997. Still, of Nuveen's \$107 billion in assets under management, \$56 billion remain in tax-exempt investments. In the past year overall assets grew 19%; through the year's first three quarters, earnings grew

16%, and Wall Street expects earnings per share this year of \$1.62. Longer term, Nuveen sees earnings growing at 10% to 12%. Net debt comes to \$136 million; operating cash flow runs more than \$200 million a year.

» **H&R Block.** With tax simplification a top priority in Washington, shares in tax preparer and lender H&R Block would seem set to suffer. Perhaps, but at \$49.59, the stock is 19% off its highs of earlier this year. The Kansas City company's mortgage business got hurt by rising rates in the fiscal first quarter, ended July, squeezing margins. But in the fiscal year's second half, Block expects the mortgage segment's margins to widen again as terms of its interest-rate hedges turn favorable. Meanwhile, Block's mainstay tax-services operations keep attracting some 16 million taxpayer clients. The stock shrugged off a Nov. 8 regulatory charge that its brokerage unit fraudulently sold Enron bonds.

The President and his fellow Republicans in Congress may succeed in holding taxes steady while reforming the tax code. But promises on taxes are notoriously hard to keep, as Bush's father learned and Bill Clinton proved again by raising taxes in his first term instead of delivering on a vow to cut middle-class rates. If precedent holds, it won't be publishers of tax-help books alone who benefit. ■

E-mail: rb@businessweek.com

Staying Ahead of the Taxman

COMPANY (SYMBOL)	PRICE*	52-WEEK RANGE	2005 EPS**	DIVIDEND YIELD
Eaton Vance (EV)	45.70	46.28-32.78	2.25	1.3%
H&R Block (HRB)	49.59	61.00-44.16	4.03	1.7
Nuveen Investments (JNC)	33.79	33.89-23.88	1.80	2.1

* Source: Standard & Poor's. ** Fiscal year ends in October. H&R Block's ends in April.

Data: ComStock, Standard & Poor's estimates

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BY GENE G. MARCIAL

SOME PROS THINK **STMICROELECTRONICS** IS STARTING TO CLICK.

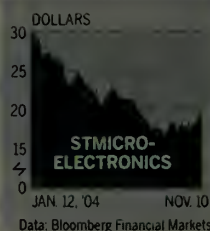
WPT ENTERPRISES LOOKS AS IF IT'S HOLDING A CLUTCH OF ACES.

MORE VARICOSE VEINS MAY SOON BE ZAPPED BY **DIOMED** LASERS

Feeling Chipper at STM

SHARES OF STMMicroelectronics (STM), one of the top five semiconductor makers, have slumped ever since 2000—from split-adjusted 74 to 19.59 now. STM appeared in this column on Oct. 11, 1999—at 26. A chip glut during a cyclical order downturn has battered the industry. But lately a few pros see STM in a brighter light. On Nov. 8, Uche Orji of J.P. Morgan Securities in London upgraded it to “overweight.” Warren Thorpe of Value Line says STM has “long-term appeal.” And Cody Acree of Legg Mason Wood Walker kept his “buy” rating, with a 12-month target of 30. A maker of chips for computers, phones, cars, and more, STM has lifted sales and earnings “when large-cap peers weren’t having much success,” says Acree. He figures STM will earn 66¢ a share on sales of \$8.7 billion in 2004 and \$1.03 on \$9.4 billion in 2005. Growth will come from strength in wireless, data storage, and consumer markets, says Acree. Morgan’s Orji sees STM profiting from Nokia’s rebound in wireless phones. Nokia makes up 17% of STM sales, and its 2005 push into camera and smart phones should be a leg up, he adds.

THE LONG DROP MAY BE OVER

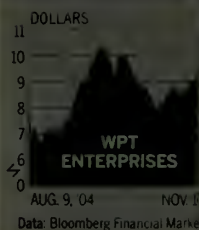


Poker: A Winning Hand For WPT?

POKER, ANYONE? The game has come into America’s living rooms through the *World Poker Tour* show, produced by WPT Enterprises (WPTE) and aired on the Travel Channel. Poker on TV isn’t the only way to play the game. Some big investors are betting on WPT stock. On Nov. 10 the stock jumped more than 10%, to 9.95, on heavy volume after CEO Lyle Berman presented an upbeat outlook at a small-cap conference in New York. Mario Gabelli, who heads Gabelli Asset Management, owns shares. “It’s a smart bet,” he says, on a young gambling outfit. Poker’s popularity is gaining, he adds, in part because of the televised tours, which produce most of WPT’s revenues. The tours have the potential to become a big hit in casinos and on the Internet, says Gabelli. He warns that WPT is a speculative bet, and investors “should not go all in.” Dennis Nielsen of investment firm Feldt, which took WPT public in August at 8 a share, rates it speculative buy. WPT is expanding the World Poker Tour concept into a brand, he says,

to produce revenues not only from licensing but also from sales of poker products, and corporate sponsorships. This year, he sees WPT earning 4¢ a share on sales of \$14.6 million and 8¢ in 2005 on \$18 million, vs. a 4¢ loss in 2003 on \$4.3 million. Although WPT sports a rich price-earnings ratio, it has potential for rapid growth—plus the cash to capitalize on varied opportunities, says Nielsen.

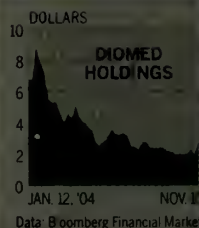
STILL SPECULATIVE



Diomed Could Get A Boost from Medicare

DIOMED HOLDINGS (DIO), a small medical-device maker, is bound to become a big player in laser removal of varicose veins. So say some investors who bought shares as they fell from 4 in June to 2.59 now. The stock hit 9 in February but collapsed soon after venture capitalists took profits on shares they bought cheap as part of a private financing. Diomed’s patented EndoVenous Laser Treatment has grown fast—and should pick up with 2005’s increased Medicare coverage, announced on Nov. 4, for removing varicose veins. “Doctors will be reimbursed at \$2,041 for the first vein and \$437 for each additional one,” says Paul Yook of Sedna Capital Management, which owns shares. Eric Sandler, of research boutique Sandler, who rates the stock a buy, has a 12-month target of 8. Diomed’s Food & Drug Administration-approved procedure involves inserting a fiber-optic catheter into the faulty vein, which is then removed by laser. No anesthesia is needed. Diomed sells the laser system for \$30,000, with a \$300 procedure kit. It also collects a fee on each treatment. Yook figures Diomed will lose money this year and next—but earn 60¢ a share in 2006 on sales of \$42 million, vs. a forecast \$25 million in 2005. ■

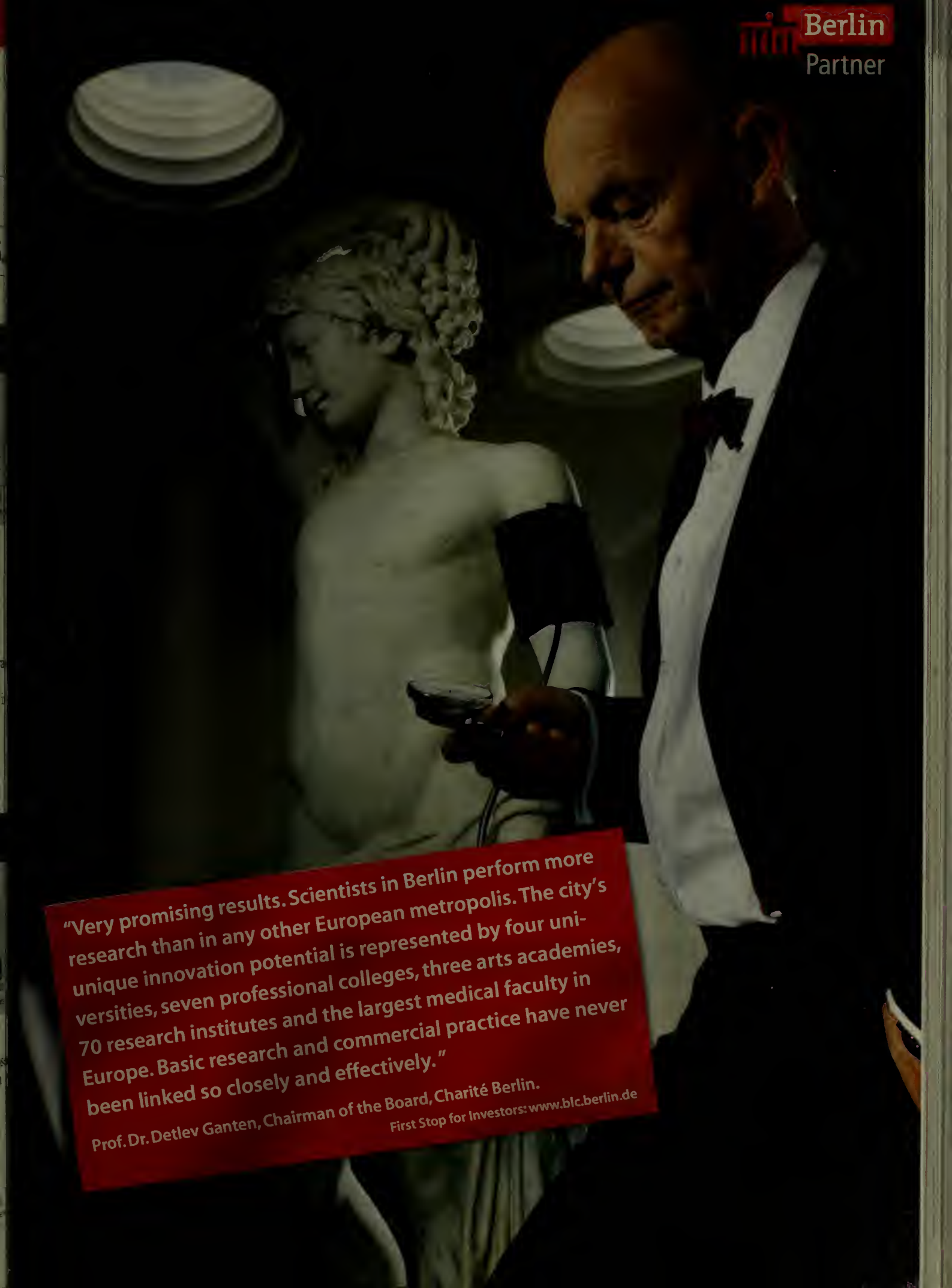
A SUMMER TUMBLE



BusinessWeek online

Gene Marcial’s Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine’s publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn’s *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

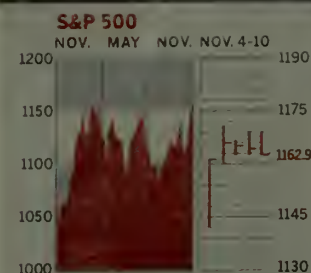
A photograph of a man in a tuxedo with a bow tie, holding a smartphone. He is standing next to a classical statue of a woman with curly hair. The background is dark with some circular light fixtures.

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STOCKS



COMMENTARY

Stocks enjoyed a post-election rally with the Dow, the S&P 500, and NASDAQ rising 2.5%, 1.7%, and 1.5%, respectively. Leading the Dow was Sears, surging on news of an investor taking a big stake, and Boeing, on the expectation that arms spending will rise under President Bush. NASDAQ, however, lagged on fears that corporate spending on technology may be slowing.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	NOV. 10	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1162.9	1.7	4.6	11.1
Dow Jones Industrials	10,385.5	2.5	-0.7	6.4
NASDAQ Composite	2034.6	1.5	1.6	4.8
S&P MidCap 400	621.3	1.9	7.9	12.4
S&P SmallCap 600	309.8	2.3	14.6	19.6
DJ Wilshire 5000	11,384.6	1.7	5.4	11.8

SECTORS

	NOV. 10	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	671.3	1.6	7.9	13.0
BW Info Tech 100**	348.1	0.5	-0.7	5.1
S&P/BARRA Growth	561.7	1.6	1.0	6.5
S&P/BARRA Value	597.0	1.8	8.2	15.7
S&P Energy	280.1	0.5	25.0	43.7
S&P Financials	394.3	1.4	3.8	8.4
S&P REIT	135.3	-0.2	16.8	21.4
S&P Transportation	230.9	2.6	14.4	15.6
S&P Utilities	137.3	2.2	16.0	24.2
GSTI Internet	158.9	0.7	9.8	14.4
PSE Technology	728.9	1.0	4.5	9.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	NOV. 10	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONTH
S&P Euro Plus (U.S. Dollar)	1290.7	1.9	9.5	24
London (FT-SE 100)	4734.5	0.3	5.8	9
Paris (CAC 40)	3784.9	0.4	6.4	10
Frankfurt (DAX)	4089.1	1.2	3.1	9
Tokyo (NIKKEI 225)	10,995.0	1.0	3.0	7
Hong Kong (Hang Seng)	13,672.4	2.1	8.7	13
Toronto (S&P/TSX Composite)	8841.7	0.0	7.6	13
Mexico City (IPC)	11,794.0	0.2	34.1	40

FUNDAMENTALS

	NOV. 9	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.65%	1.69%	1.63%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.8	19.3	26.8
S&P 500 P/E Ratio (Next 12 mos.)*	16.4	15.9	17.6
First Call Earnings Revision*	-0.16%	-0.27%	-0.06%

*First Call Co.

TECHNICAL INDICATORS

	NOV. 9	WEEK AGO	READING
S&P 500 200-day average	1119.7	1119.3	Positive
Stocks above 200-day average	70.0%	61.0%	Negative
Options: Put/call ratio	0.68	0.69	Neutral
Insiders: Vickers NYSE Sell/buy ratio	4.55	4.20	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Agricultural Products	20.3	Internet Retail	90.0
Health-Care Distributors	18.4	Steel	86.1
Food Wholesalers	17.0	Internet Software	78.0
Specialty Appar. Retailers	16.7	Fertilizers & Ag. Chems.	71.5
Airlines	15.5	Wireless Services	71.1

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Insurance Brokers	-36.4	IT Consulting	-34
Multi-line Insurers	-7.3	Semiconductor Equip.	-33
Divsfd. Metals & Mining	-6.4	Insurance Brokers	-31
Photographic Products	-6.3	Semiconductors	-25
Oil & Gas Equipment	-5.8	Airlines	-19

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Technology	6.8	Natural Resources	40.3
Europe	6.3	Latin America	36.4
Communications	5.7	Real Estate	28.0
Precious Metals	5.4	Utilities	26.9
LAGGARDS		LAGGARDS	
Natural Resources	-0.2	Technology	-1.1
Japan	0.8	Large-cap Growth	6.9
Domestic Hybrid	2.3	Small-cap Growth	7.1
Latin America	2.6	Mid-cap Growth	8.6

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFds. Intnet. Ultsr. Inv.	15.6	ProFds. Wriss. Ultsr. Inv.	83.7
ProFds. Smicdr. Ultsr. Inv.	14.4	ProFds. Energy Ustr. Inv.	67.5
ProFds. UltraOTC Inv.	12.8	U.S. Gbl. Accde. E. Eurpn.	56.4
Rydex Dyn. Veloc. 100 H	12.7	State St. Rsch. Gl. Rs. B	54.9
LAGGARDS		LAGGARDS	
ProFds. UltSh. OTC Inv	-12.1	ProFds. Smicdr. Ultsr. Inv.	-40.8
Rydex Dyn. Vent. 100 H	-12.0	GMO Emerg. Mkts. Qty. III	-38.6
ProFds. Ush. Sm. Cap Inv.	-10.0	Thurlow Growth	-35.5
ProFds. Ush. Mid Cap Inv.	-9.0	Ameritor Investment	-34.3

INTEREST RATES

KEY RATES

	NOV. 10	WEEK AGO	YEAR AGO
Money Market Funds	1.36%	1.11%	0.68%
90-Day Treasury Bills	2.07	1.95	0.94
2-Year Treasury Notes	2.84	2.75	2.02
10-Year Treasury Notes	4.25	4.07	4.40
30-Year Treasury Bonds	4.97	4.82	5.21
30-Year Fixed Mortgage†	5.70	5.67	5.95

†BankQuote 1

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.62%	4.62
Taxable Equivalent	5.17	6.60
Insured Revenue Bonds	3.82	4.70
Taxable Equivalent	5.46	6.71

THE WEEK AHEAD

PRODUCER PRICE INDEX

Tuesday, Nov. 16, 8:30 a.m. EST » October producer prices are forecast to have risen by 0.5%, after inching up 0.1% in September. That's based on the median forecast of economists surveyed by Action Economics. Minus food and energy, core prices most likely grew just 0.1%, after a 0.3% rise in the prior month.

CONSUMER PRICE INDEX

Wednesday, Nov. 17, 8:30

a.m. EST » Consumer prices for goods and services probably moved up 0.3% in October, after a 0.2% rise in September. Excepting food and energy, prices are expected to have increased by 0.2%, following a 0.3% gain.

RESIDENTIAL CONSTRUCTION

Wednesday, Nov. 17, 8:30 a.m. EST » October housing starts probably picked up to an annual rate of 1.95 million, from a 1.9 million pace in September.

INDUSTRIAL PRODUCTION

Wednesday, Nov. 17, 9:15 a.m. EST » October industrial output probably grew 0.5%, and the average operating rate most likely rose to 77.4%. In September output inched up 0.1%, and the utilization rate held at 77.2%.

LEADING INDICATORS

Thursday, Nov. 18, 10 a.m. EST » The Conference Board's October index of leading economic indicators most likely improved by 0.1%.

The BusinessWeek production index climbed to 230.6 for the week ended Oct. 30, a 12.2% increase from a year ago. Before calculation of the four week moving average, the index rose to 231.7.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.

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The Bush Plan for Social Security

PRESIDENT BUSH IS getting ready to reform Social Security—and just in time. The oldest baby boomers will turn 62 in the final year of his next term. Bush is considering proposals to allow employees to put two to four percentage points of their 6.2% payroll taxes (which are currently matched by another 6.2% from employers) into their own private accounts each year. If he proceeds, the President should make sure he gets it right (page 44). Designing these accounts—and paying for them—is going to be tricky. If the President wants to build a better retirement system, he should follow key financial guidelines.

First, the President should insist that the private accounts be set up to maximize long-term returns. That means low administrative costs that don't erode investment returns. People who have 401(k) accounts today find it hard to get information about management fees. The new accounts should have transparent and low administrative fees.

The President should recognize that many workers using these new accounts will not be financially sophisticated. Some way must be found to ensure that their investments will be balanced and diversified. A limited number of such vehicles as no-load stock index funds and inflation-indexed Treasury bonds should be made available. Churning by brokers or

putting investments into a single company or market segment could devastate returns.

Limits should be placed on withdrawals as well. Beneficiaries should not be able to raid their accounts imprudently—for consumption, housing, or even emergency health reasons. The private accounts must only be used as financial vehicles for retirement.

Private retirement accounts need low fees and index funds

Whoever manages the millions of new Social Security accounts will, in large part, determine their success. If individuals are allowed to put up to four percentage points of their payroll taxes into private accounts, about \$175 billion a year would be freed up for stocks, bonds, and other investments. Wall Street contributed heavily to President Bush's campaign and expects to manage these new funds. It should, however, earn

that right. The President should allow pension funds, such as CalPERS and TIAA-CREF and other money managers with good track records to compete.

The President would also do well to be honest about the cost of partially privatizing Social Security—\$1 trillion to \$2 trillion over the next 10 years. This is what it will take to cover Social Security's obligations to current retirees and the boomers if some payroll taxes are diverted to private accounts. The President's advisers are telling him to borrow the money and add it to the budget deficit. A better way would be to combine borrowing with gradually raising the retirement age and shaving benefit payments.

President Bush is embarking on a radical reshaping of the most important part of America's safety net. He needs to get it right.

Just Say No To More Spending

WARNINGS ABOUT the growing federal budget deficit are getting louder. Federal Reserve Chairman Alan Greenspan cautioned Congress recently that the deficit could destabilize the economy. Seven other members of the Fed have publicly warned that tax and spending policies are generating record deficits that could lead to higher long-term interest rates. As President Bush proceeds with his proposals to reform Social Security; to extend permanently tax cuts on income, capital gains, and dividends; and perhaps end the Alternative Minimum Tax, the deficit will grow. The President must get

serious on spending cuts if he is to keep control of the budget.

He can start with cutting discretionary spending. The highway and energy bills still pending in Congress are stuffed with tens of billions of dollars worth of pork. Energy companies, awash in profits, certainly don't need help from Washington. President Bush should insist that subsidies and pork be removed or veto the bills. It's time to get tough.

The biggest savings must inevitably come from cutting entitlement spending. By 2040, with most of the boomers in retirement, Social Security will absorb 6.2% of gross domestic product, up from 4.2% this year. Medicare will eat up even more, 7.4%, and Medicaid an additional 2.7% for a total of 10.1% of GDP. Entitlements are where the money is.

The President can begin by reforming his own expensive ill-designed \$1.3 trillion Medicare drug benefit. A smaller, streamlined version that provides help to those who aren't already covered by insurance could save billions. And allowing health institutions that provide drugs to seniors to bargain directly with pharmaceutical companies, as the Veterans Administration does, could save many billions more.

President Bush didn't veto a single spending bill in his first term. He should return to Republican first principles and say "no" to spending profligates in his own party.



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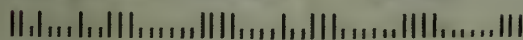
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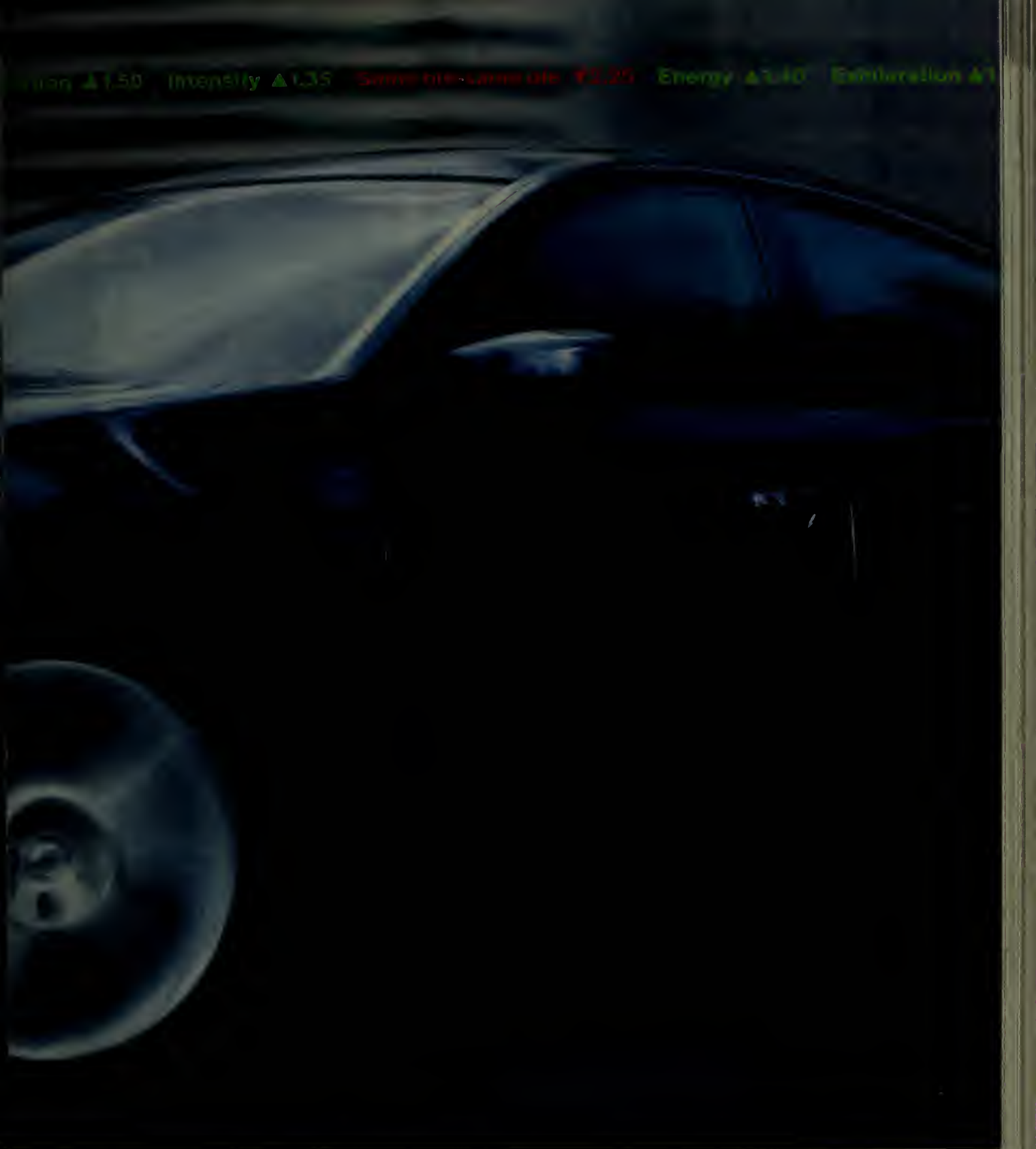
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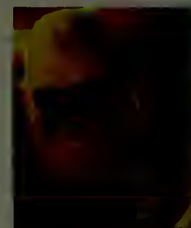
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The Superhero Exploits of High-Flying Pixar

The Incredibles makes it six blockbusters in a row for the masters of computer animation, and investors are applauding. But uncertainties about distribution deals cloud the picture for this stock



Faith, Hope, and Progress

The deficit debate demonstrates that the Democrats have become the party of hair shirts and pessimism while the Republicans emphasize a strong belief in technological progress and the future of the U.S. economy. No wonder the GOP keeps winning

Cingular Wireless: It's Tough at the Top

Now merged with AT&T Wireless, it is the industry's largest carrier. But the new champ has plenty of big challenges ahead—and former mobile leader Verizon is gearing up for a fight



A File Server...In Your Living Room?

That's right, with most homes nowadays having multiple computers and lots of files to share—everything from movies to music to home finance—these new low-cost network-attached storage devices can do wonders

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EDITED BY IRA SAGER

THE BOARDROOM NEW RULES, NEW LOOPHOLES

AMN HEALTHCARE Services, a San Diego temp agency for nurses, has found a novel way to skirt a **New York Stock Exchange** rule change. On Nov. 4, the NYSE made it tougher to be considered an

Nov. 16, 2001, AMN paid the private equity firm run by directors Robert Haas and Douglas Wheat \$2 million. That made them ineligible and would have left just three independent directors on a seven-person board, violating the NYSE's rule requiring a majority independent board.

So on Nov. 3, Haas and Wheat stepped down, only to be reappointed on Nov. 17, when they complied with the new three-year rule. **The Corporate Library's** Nell Minow calls it an "attempt to circumvent the substance of the rules." Haas and Wheat did not return calls. Says AMN CEO Steven Francis: "We're following the rules."

The NYSE agrees, noting AMN's prompt disclosure. It won't say if others have used a similar loophole. Ultimately it will be up to shareholders to decide if Haas and Wheat are truly independent. —Louis Lavelle



independent director: Any board member paid by the company during the previous three years is ineligible, up from one year.

In connection with its initial public offering on



LITIGATION NATION

Getting a Big Check From Bill

MICROSOFT CRITICS BLANCHED on Nov. 8, when one of the biggest thorns in Bill Gates's side settled litigation with the software giant. After all, the **Computer & Communications Industry Assn. (CCIA)**, backed by such rivals as **Oracle**, **Sun Microsystems**, and **Intuit**, led many of the antitrust fights against Microsoft, both at home and in Europe.

But what's striking about the settlement is that the group's CEO, Edward Black, may personally benefit, according to two sources with knowledge of the deal. Neither the CCIA nor Microsoft disclosed details of the deal. But *BusinessWeek* has learned that Microsoft paid the CCIA about \$12 million. Black could receive nearly \$2 million of that, paid out over the next few years under a new employment contract.

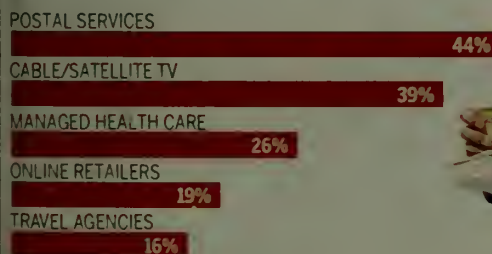
When Black broached the idea of settling with his board, he purportedly suggested earmarking a piece of the deal for his pay, something the board didn't oppose, according to one of the sources. A CCIA board member says much of what has been accomplished (with Microsoft) "has been due to Ed's tireless work."

Black declined to comment on whether he will get any money personally, or on the amount the CCIA received.

"I'm not talking about it," he says. —Jay Greene

THE BIG PICTURE

SATISFIED The percentage of U.S. consumers who say the services provided by these types of companies are "generally satisfactory."



Data: Accenture survey of 5,900 adults



SCHOOL DAYS

CALL IT THE I.V. LEAGUE

IN THE LATEST sign of consolidation in the red-hot for-profit education market, **Remington College**, in Little Rock, has put itself up for sale, *BusinessWeek* has learned. "We are considering a transaction," President Jerald Barnett Jr. confirms.

The college, which offers training in such fields as health and technology, has attracted more than 30 offers, says investment banker Michael Marino of **Jefferies & Co.** A deal could come within weeks, at a price likely to fetch between \$240 million and \$300 million.

It's the second such deal this month. On Nov. 4, private equity firm **JLL Partners** acquired the **Marco Group**, which operates a variety of schools, for \$52 million.

More deals are sure to follow. Only 25% of U.S. adults have an associate's degree or higher, says equity analyst Jennifer Childe of **Bear Stearns**. The nation's

5,000 for-profit colleges and tech schools, which offer everything from certificates in car repair to law degrees, are a popular alternative.

The industry boasts strong cash flow because students pay upfront and stay for months or years. The schools

may not have the prestige of four-year universities, but Wall Street is giving them plenty of respect these days. —Steve Rosenbush



BALLPARK PRANKS

NAME GAMES Los Angeles may be the City of Angels, but it has been hell for the Anaheim Angels as it ponders changing its name to the Los Angeles Angels. Anaheim city officials are threatening legal action. Owner **Arturo Moreno**, who bought the team last year for \$184 million, doesn't want to move. He just wants to tap the larger L.A. market. Anaheim officials, who kicked in \$30 million to renovate the stadium, are miffed that Moreno cut the city's name from jerseys, tickets, and TV broadcasts. And L.A. city officials fear that another L.A. team might prompt the NFL to put a new football team 30 miles south, in Anaheim. Isn't L.A. big enough for all of them? —Ronald Grover

RETAIL DETAILS

HO, HO, HOLD THE BUBBLY THIS YEAR

HOLIDAY CHEER may be a bit subdued for retailers this winter. **Standard & Poor's** polled managers at 22 retail companies, and 46% say they have lower expectations now about the holidays than they did six months ago. Based on the survey, S&P forecasts year-over-year holiday sales growth at 3.5% to 4.5%.

That's not bad, but slower than the 5% jump in 2003—the best since 1999. Mitigating factors: lingering economic concerns, geopolitical strife, and energy costs. Better news: 55% of respondents expect improvements in 2005. —Brian Hinde

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FACE TIME

ALEX ZOGHLIN



A STARTUP GUY WHO NEVER STOPS

In 1999, Alex Zoghlin, a former U.S. Navy encryption specialist and Web pioneer, helped launch an online venture for Boston Consulting and some airlines. You've probably heard of it by now: Orbitz, the travel-booking site that Cendant bought for \$1.25 billion on Nov. 12.

Zoghlin is at it again. After resigning as Orbitz' chief technology officer last year, he opened Chicago-based G2 SwitchWorks, which promises to make it easier and cheaper for travel agencies to buy airline tickets online. Zoghlin is betting that they'll want an alternative to Galileo International (also owned by Cendant), Sabre, and Worldspan Technologies, which control the airline-reservation system.

These days, Zoghlin, a 34-year-old ex-triathlete, is busy changing diapers for his three small children. But he still has time to go fishing with Orbitz pals and run G2. "I'm a startup guy," he says. G2 is his fourth e-venture; the first three left him a rich man. Try telling him the Internet was just a bubble. —Michael Arndt

THE CARIBBEAN PRICIER PORTS FOR CRUISE SHIPS

TIME WAS WHEN Caribbean islands jockeyed to provide port to cruise ships brimming with free-spending tourists. That isn't always the case anymore. After spending millions to upgrade their ports to handle the modern megaships, some Caribbean locales are placing restrictions on cruise lines such as **Carnival** and **Celebrity Cruises**. Several islands have concluded that the hordes of passengers who disembark burden their infrastructures without spending enough to make it worth their while.

After being deluged with as many as 13,000 cruise passengers each day—a swarm equal to 5% of its population—Belize has begun limiting the number of disembarking passengers to 8,000 a day. Similarly,



ALL ASHORE Trouble handling the hordes

Bermuda and the Cayman Islands have started to restrict the number of ships that can dock each week. Other governments, including St. Lucia, Jamaica, and Antigua have started imposing cruise taxes—roughly \$5 to \$10 per passenger. Playa del Carmen went so far as to scuttle plans for a new cruise-ship dock after Carnival balked at

paying a proposed \$30-per-head passenger fee.

The cruise industry insists such rejections are the exception. Says Michele Paige, president of the **Florida-Caribbean Cruise Assn.**: "We have the best relationship with the Caribbean that we've ever had." Still, any restrictions represent a setback for an industry that has long been used to being treated like the belle of the ball. —Dean Foust

AFTERLIVES NOW THAT'S GETTING AWAY FROM IT ALL

FOR HIS SECOND ACT, America Online co-founder Stephen Case chose a field far removed from cyberspace. *BusinessWeek* has learned he will announce on Nov. 22 that he has become chairman of Denver-based Exclusive Resorts, a luxury vacation home club.

The former online entrepreneur now wants to change the world of luxury travel by offering access to some 300

high-end vacation homes worldwide. Club members pay a one-time \$375,000 fee and annual dues of up to \$25,000. By helping members avoid the expense of home ownership, Case, 46, says he wants to make such luxury abodes "more affordable to more people."

Case, who owns more than 50% of the year-old company, has scouted sites for homes

in balmy locales ranging from Kapalua Bay in his native Hawaii to Papagayo, Costa Rica, where he plans to build treetop homes. Not a bad way to retire from the online business.

—Catherine Yang



CASE Vacation is his vocation

THE STAT

49

The number of U.S. cities with at least one square mile of municipal wireless broadband access. Philadelphia is the latest to reach that milestone, and Seattle recently announced plans.

Data: Tropo, Network

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CELEBRATING



As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

Your Mortgage Was His Bond

THE PAST QUARTER-century has seen a revolution in finance. It's felt every time a homeowner refinances a mortgage or signs up for a credit card. No one person can claim to have lit the fuse for this revolution—but Lewis S. Ranieri was holding the match. Joining Salomon Brothers' new mortgage-trading desk in the late 1970s, the college dropout became the father of "securitization," a word he coined for converting home loans into bonds that could be sold anywhere in the world. What Ranieri calls "the alchemy" lifted financial constraints on the American dream, created a template for cutting costs on everything from credit cards to Third World debt—and launched a multibillion-dollar industry.

Salomon and Bank of America Corp. developed the first

private mortgage-backed securities (MBS)—bonds that pooled thousands of mortgages and passed homeowners' payments through to investors—in 1977. Not a moment too soon: Skyrocketing interest rates were turning the business of savings and loans—funding long-term mortgages with short-term deposits—making it a financial death trap for banks just as the housing demands of maturing baby boomers began to surge.

Ranieri's job was to sell those bonds—at a time when only 15 states recognized MBS as legal investments. With a trader's nerve and a salesman's persuasiveness, he did much more, creating the market to trade MBS and winning Washington lobbying battles to remove legal and tax barriers.

A less likely financial engineer would be hard to imagine. Ranieri, a Brooklyn native, set out to be an Italian chef until asthma ruled out work in smoky kitchens. A part-time job in Salomon's mail room set him on the path to trading. A large, volatile man, Ranieri built the firm's mortgage desk in his own image: "fat guys," as author Michael Lewis described them in *Liar's Poker*, promoted from the back office, who indulged in feeding frenzies and practical jokes while selling strange new

bonds to doubtful investors.

Ranieri turned home loans into tradable securities

But Ranieri also recognize that "mortgages are math." He hired PhDs who developed the "collateralized mortgage obligation," which turns pools of 30-year mortgages into collections of 2-, 5-, and 10-year bonds that could appeal to a wide range of investors. The homeowner in Albuquerque could now tap funds from New York,

Chicago, or Tokyo, a change that Ranieri figures cut mortgage rates by two percentage points. Soon everything from credit-card balances to auto loans was being repackaged.

As MBS trading exploded in the '80s, Salomon dominated the market. After becoming vice-chairman, Ranieri was seen as "too big" in the trade by his bosses and was forced out in 1987. Now he is non-executive chairman of Computer Associates International Inc. and runs his own investment firm. And the market he created has funneled trillions into the American dream of homeownership. ■

—By Mike McNamee





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What happens when you need surgery and you don't have the funds to meet your \$2,000 or \$3,000 deductible?"

—Steve Scheffel
Cincinnati



BETTER WAYS TO EXPAND HARVARD'S GLOBAL REACH

RE "HARVARD: TOPS IN...engineering?" (Up Front, Nov. 8): The plan of Harvard President Lawrence Summers to expand the university's engineering program to achieve international stature is a waste of the endowment fund. With a premier engineering school at Massachusetts Institute of Technology in the same locale, it would make more sense intellectually and financially to devise a program where engineering hopefuls at Harvard could take courses at both Harvard and MIT with a dual degree issued by the two institutions. Partial or total funding by Harvard would surely be a more attractive financial venture than supplying money for an enhanced program at Harvard alone that would require years to earn the reputation of the MIT curriculum.

—Nelson Marans
Silver Spring, Md.

WHERE'S THE JUSTICE IN DUMPING PENSION LIABILITIES?

RE "MELTING AWAY steel's costs" (News: Analysis & Commentary, Nov. 8): *BusinessWeek* is accurate in saying that Wilbur L. Ross Jr. did nothing illegal by

acquiring bankrupt steel companies and dumping their pensions onto the federal Pension Benefit & Guaranty Corp. That said, the legality of the U.S. code and federal policy has little to do with fiscal (and generational) justice and ethics. As a faithful subscriber, I expect some form of public service from *BusinessWeek* when it comes to highlighting seriously flawed government financial arrangements. Ross should be ceremoniously dubbed an enemy of the U.S. Treasury.

—Chad James
Alexandria, Va.

AMERICA GETS HARDLY ANY ELECTRICITY FROM OIL

THE ARTICLE "With oil over \$50, nukes are back" (Washington Outlook, Nov. 8) is based on the incorrect assumption that oil is used extensively to generate electricity in the U.S. In fact, the U.S. produces almost no electricity from oil. According to the Energy Information Administration, in 2003 only 3% of the nation's electricity was produced from oil. Coal (51%), nuclear (20%), natural gas (16%), hydroelectric (7%), and other renewables (2%) accounted for the rest of U.S. electricity production. Most of the small amount of

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "The online ad surge" (Web Smart Special Report, Nov. 22), a quote from Alan Ives, vice-president of ABC Interactive, could have been interpreted to mean that advertisers were losing interest in network ads. That was not his point. He meant to say that advertisers, in their attempts to reach customers throughout the day, are using new approaches on various media—in addition to network TV spots.

oil that is used to generate electricity is for peaking [highest-demand] purposes, a service for which investment in new nuclear power plants is not conceivably economical. The most sensible rationale for investing in new nuclear power plants is to reduce carbon-dioxide emissions produced when coal and natural gas are burned to produce electricity—not to respond to high oil prices.

—Paul L. Joskow
MIT Center for Energy
& Environmental Policy Research
Cambridge, Mass.

A DISTURBING GAP IN HEALTH SAVINGS PLANS

"YOUR NEW HEALTH PLAN" (Special Report, Nov. 8) missed a troubling aspect: Unfunded or underfunded health savings accounts and the very real potential of a cost shift to providers (physicians and hospitals). What happens when you need surgery and you don't have the funds to meet your \$2,000 or \$3,000 deductible? You ask for a payment plan from the health provider. Now the health provider is on the hook to collect from the patient. So even though the cost to the employer goes down and the employee saves money through smaller health-insurance premiums, the accounts receivable of the health-care providers goes up.

How does this save the system money?

—Steve Scheffel
Cincinnati

MEDICAL SCHOOLS NEED TO TEACH STATISTICS AND STUDY DESIGN

READ "THIS PEP PILL is pushing its luck" on Provigil (Science & Technology, Nov. 1) and contrasted it with "Why drugs need a longer look" (BusinessWeek Online, Oct. 28) on Vioxx by the same author. I checked for common adverse effects for Provigil on ePocrates and found a variety that occur at least 2% of the time: headache, nausea/vomiting, rhinitis, diarrhea, nervousness, pharyngitis, dizziness, dry mouth, anorexia, depression,

anxiety, respiratory disorders, cataplexy, insomnia, elevated liver transaminases, dyskinesia, hypertonia, dyspnea, hypotension, and hypertension.

As a professor of psychopharmacology who also runs a clinic for attention deficit hyperactivity disorder (ADHD), I am astounded that physicians use this drug so frequently. U.S. medical education lacks scientific training in statistics and study design, which are needed to elevate the art of medicine to the science of medicine. With proper training, our physicians should be able to make informed judgments about drugs such as Provigil and prevent another Vioxx fiasco!

—David Reinhardt
Long Beach, Calif.

HARVARD B-SCHOOL: OUR MBAs GET THE LION'S SHARE OF JOB OFFERS

BUSINESSWEEK'S criticism of the Harvard Business School Career Services Office ("Best B-Schools" Special Report, Oct. 18) just doesn't add up. The nearly 900 members of HBS Class of 2004 received a higher percentage of job offers at graduation (94%) and three months after graduation (96%) than any school in the survey. The median salary of \$147,500 was second by a margin of 1.7%, while your corporate poll put HBS in the top two. And job postings for the Class of 2004 jumped by almost 40%.

These figures drew high approval ratings from our students. They also attest to the fact that recruiters like what they find. If they have a problem, it may well be that our supply of students can't keep up with companies' demand for them.

—W. Carl Kester
Senior Associate Dean &
Chairman of the MBA Program
Harvard Business School
Boston

How to reach BusinessWeek

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"HOW CAN
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CHEESES BE
AT THE
CUTTING EDGE
OF THE SEMI-
CONDUCTOR
INDUSTRY?"

Pasquale Pistorio of
STMicroelectronics
discovers that the
French passion for
Research &
Development
matches his passion
for the food.

(see next page)

Is Welfare Reform Working?

AMERICAN DREAM Three Women, Ten Kids, and a Nation's Drive to End Welfare
By Jason DeParle; Viking; 422pp; \$25.95

Delegates at the Republican National Convention this summer cheered President George W. Bush's acceptance speech with a zeal ordinarily reserved for Super Bowl matches. But there was only a smattering of applause for one line: a call for welfare recipients to work longer hours. The lackluster response showed

how an issue that rightists once found rousing has dropped off the radar. It has been eight years since Bill Clinton signed welfare reform into law. Now, to the extent that most voters think about the revamped system at all, they regard it as an unmitigated success story, not a rallying point.

The narrative goes something like this: Time limits on benefits and tougher work requirements prodded welfare mothers to land jobs for the first time. As a result, not only are families benefiting economically but they also are gaining a new sense of purpose. Inspired by their mothers' example, children will feel inspired to establish their own place in the middle class as adults.

The legacy of welfare reform is much more ambiguous, as Jason DeParle, a senior writer at *The New York Times*, makes clear in *American Dream: Three Women, Ten Kids, and a Nation's Drive to End Welfare*. This superb and affecting book employs a two-track narrative. Tapping his experience as the *Times's* point man on welfare reform, DeParle provides a thorough description of the evolution of poverty policy. Interspersed are rubber-meets-the-road accounts of the consequences, good and bad, of those Washington debates on three Milwaukee women, who DeParle followed over a seven-year period.

Critics might allege that DeParle's sample is too small and therefore not as persuasive as a larger study might have been. Still, the author's nuanced portrayal of the women's experience is eye-opening and sobering. Two get low-income jobs, which they must juggle along with single parenthood. They move up the social ladder just a bit: Under welfare, Angela Jobe, DeParle's main character, has a total income of around \$21,500. Later, after taking on double shifts as an aide to the elderly, Jobe earns just under \$25,000. But DeParle's third character, Opal Caples, succumbs to crack addiction and loses custody of her children. The welfare bureaucracy does little to break her fall, nor does it provide much help to the two working women, who would have benefitted from quality after-school programs, for example. Still, welfare reform was accompanied by an expansion of the earned-income tax credit,

providing annual checks that have proved crucial to the women. And many states, including Wisconsin, offered new services, such as transportation subsidies and child care.

Jobe's children don't seem to have benefited from her new life. Once she started working around the clock, they attended school even less often than before. Unsupervised for hours at a time and living in a dangerous neighborhood, they began experimenting with drugs and sex. At the end of DeParle's narrative, Jobe's 17-year-old daughter is pregnant. She breaks the news to the father at his eighth-grade graduation.

DeParle debunks many myths surrounding the old system. For example, conservatives once argued that welfare benefits rewarded and therefore encouraged out-of-wedlock births in the African American community. DeParle shows the cause-

and-effect link to be less clear, citing studies that demonstrate the existence of a fluid family structure dating back decades to rural life in the South.

DeParle also punctures the notion that welfare recipients didn't work before the change in the law. Most did, at least sporadically—they just didn't report the jobs to the government. One reason the welfare rolls dropped by more than half after the 1996 law is that recipients who were already working off the books weren't willing to shoulder the additional burden of new workfare requirements, such as having to clean public buildings or sort mail.

Finally, the author considers Wisconsin's welfare-to-work program, once held to be a model of achievement. That reputation doesn't stand up

to scrutiny. Corruption and inefficiency dogged the private companies contracted to provide caseworkers—those charged with shepherding former welfare recipients to self-sufficiency. Caseworkers often did nothing, and in some cases were predatory—even pressuring clients for sex and a cut of welfare checks.

That isn't the book's only disturbing story. In one scene,

Jobe's youngest son throws himself to the floor crying because he is hungry. In another a 50-year-old woman loses her kids and is expelled from a homeless shelter after a drug binge. Still, DeParle ends on a hopeful note. He points out that welfare reform's elimination of no-strings cash handouts cleared the path for a new debate over ways to help the poor. Health insurance, quality after-school care, and efforts to reach out to urban black men can make a huge difference. And yet, given the political climate, a drive to ease the burdens of the working underclass is likely not in the offing, no matter how great the need. ■

—By Alexandra Starr



Insufficient child care and other support undercut a good idea

Pasquale Pistorio, President and CEO of STMicroelectronics, says the French have a passion for business.

What is STMicroelectronics?

We are one of the world's largest semiconductor companies with some 50,000 people, 9 billion volume in sales, and a worldwide presence. Our market is the world, our mission is to serve the world. And France has assumed a key role in achieving this goal.

Why have you so heavily invested in France?

The microelectronics industry is driven by innovation and creativity and depends on the intellectual value added: the human capital. The quality of advanced education in engineering and mathematics is second to none. We don't work in isolation. We network with research institutes and universities, and the culture in France is very open to cooperation.

What about the cost of doing business? How do you find the tax structure?

It's a lot more favorable than you would think. France has a real passion for R&D and has passed tax laws to promote it. We are spending over \$500 million a year on R&D in France. Now, we can deduct some \$25 million from our tax debt. The Government is also creating competitiveness clusters where the cost of social benefits for researchers is being cut by 25 percent. A huge saving!

You talk about innovation. How can a country which values its traditions (it makes over 400 cheeses for example) be innovative?

Innovation means creating new things. But to be creative you need deep roots. People are not computers. They have

a brain, a heart and a soul. And the culture is the soul. The French are rightfully proud of their culture. It's the rich soil from which new ideas can grow.

Can you really attract the best people to work in France?

STMicroelectronics in France

- Established in France since 1987 with roots dating back to 1956
- 9,500 employees in France including 3,500 engineers
- Partnership with Philips and Freescale (formerly Motorola) has produced one of the most advanced nanotechnology R&D centers in the world, at Crolles 2 France

This is the first time in our industry that Americans are coming to Europe to join the R&D of Europeans. At Crolles - imagine Silicon Valley with skiing - we have created the most advanced R&D center in Europe, and one of the best in the world. A colleague of mine tells the story about one of his people who was transferred to France who said:



"This is the first time in our industry that Americans are coming to Europe to join the R&D of Europeans."

"This is paradise. We should pay you to live here. You shouldn't have to pay us."

What is your greatest achievement in France?

There's one basic acid test of success. In the last 15 years there was not one year when we didn't keep growing employment. Even this year, when our competition is shrinking its resources to reduce overheads, we have been taking on more people.

Have you anything negative to say about France?

Yes. The food. It's a problem for me. There is such good eating. Wonderful cuisine (and not just French) everywhere. And, unfortunately, I really must watch my waistline...

For more information on investing in France, visit www.thenewfrance.com



BY STEPHEN H. WILDSTROM

Microsoft Is No Threat To Google—Yet

In the past decade, searching the Web has grown from an academic experiment to a multibillion-dollar business. Microsoft has not been a player, being content to outsource its MSN Search service to rival Yahoo! Now, Microsoft is offering a homegrown search engine, but, despite some nice touches, it has a long way to go to challenge industry leader Google.

A public trial of the new service launched on Nov. 11, and it has some very rough edges that suggest it was pushed out before it was quite ready. Still, it's a big improvement over the old Yahoo-powered MSN Search, which is what you still find at the standard MSN search page and the MSN Toolbar. To use the new service, you must go to beta.search.msn.com. There you will see a simple, clean search form. You type in your search term and click either the "search" or "near me" button. The first runs a standard Web search. The second restricts the scope to a city or region.

The odd results generated by a "near me" search reveal the considerable gap between Microsoft's ambitions and reality. The top 10 results in a search for "furniture stores" in Washington turned up a newspaper in Kenai, Alaska, but no furniture stores closer than New Jersey. By contrast, local searches at Google and Yahoo both gave 10 Washington furniture stores.

When you type in a search term that can be interpreted as a factual question, Microsoft will try to give you a simple answer from its Encarta encyclopedia. For example, "capital of Ohio" returned the answer "Columbus" and a click on "Encarta Answers" took you to additional information on Ohio. Unfortunately, the encyclopedia search is buggy. "Who shot Lincoln" prompted MSN to ask "Were you looking for 'who shot' near Lincoln, Neb." Typing in "President of France" offered no answer but did give a link to a speech presented in France by the president of the Church of Scientology.

ONE HELPFUL TOOL IN THE NEW MSN SEARCH is the Search Builder, which gives advanced users an easy way to fine-tune results. You can tweak the search algorithm to vary the weight given to the preciseness of the match, the popularity of the site, and the frequency with which it is updated. You can do the same thing in Google, but only if you know some arcane query commands. You can also restrict the search by country, region, or language, limit it to a specific site or domain, or get only a listing of pages that link to a specified site. And the



search-results pages are clean: The only ads are clearly identified sponsored links that are even less intrusive than Google's.

Like Google, Microsoft offers the option of restricting your search to images and news sources. But unlike Google's eclectic collection of media outlets from around the world, Microsoft favors a relatively small collection of well-known, mostly U.S. sources. Usually the first result comes from MSNBC—one of the few places, besides Encarta, where Microsoft has succumbed to the temptation to promote its own products and services.

Microsoft does not plan to make the new version the official MSN Search until early next year. That gives it plenty of time to fix the glitches. The company is also still building its index of the Web and says when it is finished, it will not only be bigger than Google's but will be updated far more often. In the meantime, however, Google is going to find things that Microsoft misses.

Microsoft's next big search move will come in a few weeks when it supplements its new Web search with a desktop tool that

If the new search's loads of glitches are fixed fast, it has huge potential

will find files on your computer, as does the new Google Desktop Search (BW–Nov. 22). Microsoft's unparalleled ability to integrate its search tools into Windows, Internet Explorer, Outlook, and other Microsoft Office components could give it a huge competitive advantage. But first it must greatly improve the quality of its new search service. ■

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BY GLENN HUBBARD

How Bush's Plan Would Secure Social Security

President George W. Bush has promised that Social Security reform will be a domestic priority over the next four years. It's a top priority because the oldest baby boomers will start to retire at the end of the President's second term. The President has proposed "personal accounts" in which you could deposit a portion of your current payroll tax into an investment account

you would actually own. Unlike Social Security, you could pass this asset onto your heirs. At the same time, most of the current payroll tax would continue to fund traditional Social Security benefits to current retirees.

This reform would strengthen opportunities to build wealth for millions of Americans, many of whom have few financial assets today. Personal accounts also offer a surer way to prefund our obligation to pay future Social Security benefits. While lawmakers find it difficult to "save" rather than spend Social Security surpluses (the excess of current payroll tax over current benefits), personal accounts would be off-limits to politicians. The emergence of Social Security reform as a domestic policy priority is encouraging, but the focus on personal accounts raises both challenging questions and questionable challenges that need to be addressed.

CHALLENGING QUESTIONS. To start, what are the objectives of Social Security reform? One obvious objective is to advance the President's ownership society agenda. The transition costs to personal accounts will actually put Social Security on a firmer footing. As long as future net obligations are reduced by prefunding Social Security benefits through personal accounts, the diversion of a portion of payroll taxes to personal accounts is akin to prepaying part of a mortgage. If the transition costs are borrowed, the resulting higher explicit federal debt in the near term is offset by lower implicit debt (Social Security obligations) in the longer run. The present value of Social Security's unfunded liabilities is lowered.

This point relates to the second challenging question. Will the reform put Social Security on a better financial footing? The long-term funding gap facing Social Security is large because promised benefits exceed payroll tax receipts by trillions of dollars. Personal accounts alone will not secure Social Security's long-term financial future. The President has stated that there would be no change for current retirees or those nearing retirement. Hence, to close the gap without raising taxes, younger workers will need to receive lower benefits relative to their previous earnings than today's retirees do.

Under current law, initial benefits are indexed to average wage growth in the economy during the years that the retiree

worked. Since young workers start their careers at a higher wage level than older workers, they get a larger Social Security benefit in real terms when they retire. One reform plan that replaces this wage indexing with price indexing eliminates almost all of the unfunded liabilities of the system. Benefits received relative to wages would decline (along with Social Security's liabilities), but they would be supplemented by expanded savings from the personal accounts.

QUESTIONABLE CHALLENGES. Some critics argue that personal accounts would expose workers to too much risk, and administrative costs would fritter away account balances. But personal accounts could be invested in a mix of inflation-indexed Treasury bonds and broad stock portfolios to keep risk low over the long run. If investment choices are limited to bond and stock-index funds, administrative costs will be very low. The government could pay for such costs in the beginning.

Funding a personal account is like prepaying a mortgage

Won't personal accounts limit Social Security's ability to make transfers from higher-income to lower-income workers? Not necessarily. One plan for Social Security reform would be to build

in a higher ratio of benefits to wages for lower-income workers than higher-income workers. A proposal by Robert C. Pozen, Sylvester J. Schieber, and John B. Shoven would strengthen benefits for low-income retirees and reduce Social Security's unfunded liabilities by more than 70%.

Reform can deliver individually owned retirement accounts, a more stable future for Social Security, and a continued commitment to low-income seniors. These issues may well dominate the domestic policy debate once President Bush reveals his plans. ■

Glenn Hubbard is dean of Columbia Business School. He chaired the Council of Economic Advisers from February, 2001, to March, 2003 (rgh1@columbia.edu).

BY JAMES C. COOPER & KATHLEEN MADIGAN

Could Trade Imbalances Topple the Greenback?

Pressure from currency markets makes fixing the trade gap a delicate task

U.S. ECONOMY

The ever-growing deficit in America's international trade is a bomb waiting to explode, but one with a very long fuse. That's why for years economists and policymakers put the deficit low on their list of worries. The lack of urgency stemmed from the glacial pace of the gap—it has been widening for 13 years with no problems—

and from the fact that the U.S. remains the most attractive destination for foreign funds.

Recently, however, the fuse seems to be burning a lot more quickly. Currency markets, increasingly edgy about the deficit, are pushing down the dollar. Overseas officials and international trade organizations have called on the U.S. to deal with the problem before it inflicts global pain. And policymakers at the Federal Reserve took time at their Sept. 21 policy meeting to discuss the "worrisome further widening of the U.S. trade and current-account balances." At the same time, growing economic tensions, especially in Europe, and contradictory statements from the White House about the dollar suggest that correcting the current-account deficit will be risky.

Indeed, no easy solutions lie on the horizon. Stronger global demand could help U.S. exports, but prospects abroad are not encouraging. Third-quarter growth in both the euro zone and Japan undershot expectations, and China's efforts to cool off its economy are hurting much of Asia. Boosting U.S. savings would lessen America's dependency on foreign funds, but Washington seems uninterested for now in reducing the main drain on savings, the federal deficit. Rising federal red ink only intensifies the U.S. need for foreign capital and worsens the trade gap as it stimulates U.S. demand.

Even a slow decline in the dollar may not be much of an elixir, because the drop is concentrated against a limited number of currencies, and thus a limited volume of U.S. trade. Worse still, given that currency markets often lurch instead of stroll, a strategy that relies largely on a weaker dollar could backfire. A sharply lower dollar would feed inflation pressures, boost long-term interest rates, and severely complicate the Fed's efforts to foster maximum sustainable growth. The October producer and consumer price indexes suggest at least a small dollar-related pickup in inflation outside of energy and food.

HOW DID THE DEFICIT GET SO BAD? For more than a decade, the global economy has become increasingly dependent on U.S. growth, while the U.S. has become more dependent on foreign capital to finance its demand. This cycle snowballed the deficit in the U.S. current account—the broadest measure of international trade and financial

flows—to a record 5.7% of gross domestic product, a level exceeded only by the emerging nations Hungary, Bulgaria, and the Czech Republic. Foreign money now finances three-fourths of U.S. net investment (chart).

Restoring some balance in global trade is potentially explosive because a successful adjustment requires so many pieces to fall into place at the right time. The U.S.

trade deficit has to shrink without the dollar crashing. And trade flows have to shift, but without doing serious harm to global growth and financial markets.

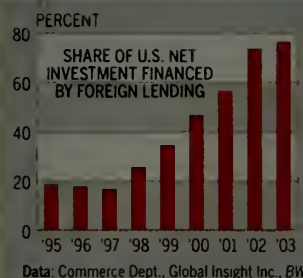
Plus, accomplishing all this will require coordinated monetary and fiscal policies. The U.S. will have to tighten either monetary or fiscal policy—preferably both.

The European Central Bank must cut interest rates, and Japan must solve its long-running banking problems. China and many Asian governments have to loosen their grip on their currencies. And all countries must restrain themselves from protectionist urges.

IT'S A TALL ORDER, especially given the Bush Administration's penchant for acting unilaterally rather than in conjunction with other governments. Choosing to go it alone on this effort risks unleashing the wrath of the currency markets. Given the dollar's slide, they may already be losing their patience with current efforts.

In particular, forex markets seem dismayed by the prospect of large U.S. budget deficits. And traders are paying less attention to the Bush Administration's dollar mantra, most recently chanted by Treasury Secretary John W. Snow, that "a strong dollar is in America's interest." Instead, traders are focusing on the White House's other—and opposite—message that "currency values are best set in open and competitive exchange markets." Since current fundamentals strongly argue for a weaker dollar, forex markets seem willing to give the

A GROWING DEPENDENCE ON FOREIGN MONEY



Administration what it is not so subtly asking for.

In the past, that would not be a bad thing. A weaker dollar was a major weapon for bringing down the trade deficit. For example, the 1985 Plaza Accord among major nations brought down the dollar, and the U.S. current account shrank from 3.5% of GDP to near balance by 1990. But relying on a dollar remedy will be a lot trickier this time because trading patterns have changed so dramatically and many key trading partners closely manage their currencies.

According to Fed data, the dollar is down 13% against a broad range of currencies since its peak in February, 2002. But that number doesn't tell the whole story. To gauge the U.S.'s global competitiveness, the Fed also calculates two subindexes of the trade-weighted dollar. The first compares the dollar to seven major currencies: the euro, pound sterling, Japanese yen, Swedish krona, Swiss franc, and Australian and Canadian dollars. The second index measures the dollar vs. the currencies of 19 other countries, which the Fed labels "Other Important Trading Partners" (chart). Together, these 26 regions account for about 85% of U.S. trade flows.

THE DATA REVEAL that the dollar's decline has been concentrated in a 25% drop against the major currencies of countries that account for 46% of the volume of U.S. trade. However, against the OITP currencies, the dollar is actually up 5%, and these countries make up 40% of U.S. trade volume. Not surprisingly, the U.S. merchandise trade deficit has deteriorated more against the OITP

group. On a 12-month moving average, that gap has widened 56% since February, 2002. The U.S. goods deficit with the major nations is 34.6% bigger.

The problem isn't just China. Excluding China, the U.S. deficit with the OITPs is still 41% bigger than it was in February, 2002. And in the past year, the U.S. gap with the seven major trading regions has worsened just as much as the gap with China has, even though the dollar is down 5% vs. the major currencies and not at all vs. the yuan.

Why hasn't the dollar narrowed the trade deficit, even in areas with strengthening currencies? Strong U.S. demand, compared to

that in other regions, has overwhelmed the constraints of the dollar's weakening. In effect, hefty stimulus from U.S. tax cuts and low interest rates has skewed global growth and helped out foreign producers.

In the coming year, economic tensions are bound to rise, as the global trade imbalance gets worse before it gets better. The onus will fall on the Bush Administration to take the lead in achieving a benign resolution. But if government policy fails, the currency markets will step in. And their remedy could be much more painful. ■

THE DOLLAR'S DECLINE IS NOT WIDESPREAD



JAPAN

Pinning Hopes on Consumers

JAPAN'S ECONOMY stumbled in the third quarter. A deceleration in foreign demand was the main culprit, and a sudden turnaround in exports appears unlikely. That puts the economy in the unexpected position of having to rely on consumers as the source of growth for the time being.

Third-quarter real gross domestic product grew by an annualized pace of 0.3%, down from 1.1% in the second quarter, which was below the first quarter's 6.3%. A lower net export surplus cut two-tenths of a percentage point off growth, the first such subtraction in two years.

Manufacturers are seeing a slowdown in demand not only from abroad but also from reduced domestic

capital outlays. Business investment was off by 0.9% in the third quarter.

Conditions are not likely to change much heading into 2005. On Nov. 16 the government's *Monthly Economic Report* said "weak movements" in the economy have emerged. Machinery orders fell 8.4% in the third quarter. Plus, a nearly 6% rise in the yen vs. the U.S. dollar since September is raising concern about export growth to its largest market. Some officials are hinting at possible intervention in the currency markets.

Weaker exports and corporate spending mean consumers are the key to growth. Once a weak link, household spending grew 3.7% in the third quarter. The jump was due in part to hot

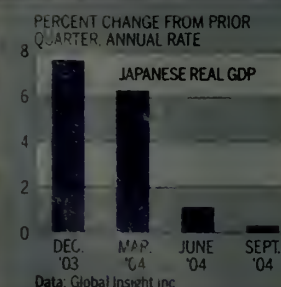
summer weather, which led to a rush to buy air conditioners, as well as brisk sales for televisions ahead of the Olympics.

There are reasons to believe consumers can keep spending. Consumer confidence rebounded to 47.7 in October and remains close to the 13-year high of 49.2 in August. The labor market is also stabilizing. Job growth was up 0.5% from a year ago in September, although most of the gains came from part-time hires.

However, it does not appear that the consumer rebound is truly self-sustaining. There is still a divergence in compensation between the service sector and manufacturing, with only the latter seeing gains in wages and bonuses. Therefore, a turnaround in exports and capital spending will be required to avoid a backslide in factory wages and prevent Japan's economy from stalling out. ■

—By James Mehrling in New York

THE ECONOMY LOSES STEAM





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Youth Smoking Prevention

Quitting Smoking

Responsible Marketing

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News Analysis & Commentary



STAR POWER
For investors,
Lampert has
become a brand
unto himself

MERGERS

EDDIE'S MASTER STROKE

The Sears-Kmart merger creates a retail giant—and a platform Lampert can use for more deals

EDWARD S. LAMPERT HAS made no secret of wanting to follow in the footsteps of his hero, Warren E. Buffett. Like the Sage of Omaha, Lampert formed a partnership at age 25 and invested in old-line companies that throw off lots of cash. And just as Buffett did with Berkshire Hathaway Inc., Lampert gained control of bankrupt discounter Kmart Corp. last year, hinting he would turn it into a powerful investment vehicle. Then, on Nov. 17, Lampert swooped in and launched an \$11 billion purchase of Sears, Roebuck & Co.

Most investors loved the deal. Kmart's stock soared 8% the day of the announcement—instead of falling, as the stocks of an acquiring company usually do—fetch-

ing a huge premium over the value of Kmart's business. The reason is simple: Many investors are buying Lampert, not Kmart, and they see Kmart not as a retailer trying to move product but as a springboard for lucrative deals. "This is the first move of many in the years to come with [the merged company] as [Lampert's] investment vehicle," says John C. Phelan, a former Lampert associate who is now managing partner at MSD Capital, which manages money for Dell Inc. founder Michael S. Dell.

TREASURE CHEST

STILL, LAMPERT'S LATEST move didn't please everyone. Some fear he will get bogged down for several years trying to turn the two struggling retailers around rather than using the formidable cash pile

Kmart is amassing to move more quickly into other, more promising investments. "Kmart shareholders may not appreciate the merger," said UBS analyst Gary Balter in a report. "The hope was that ESL would take a bold move with the cash and start to invest in growth opportunities. This is not the type of move we were looking for to create the next leg of value for shareholders."

Yet for now, that appears to be a minority view. And there's little question that the merger, if it succeeds, will eventually arm Lampert to the teeth to pull off more deals. He's squeezing cash out of every corner of Kmart and has built a \$3 billion cash hoard. Sears has its own \$2.7 billion cash reserve that will grow as Lampert wrings inefficiencies out of the aging department-store chain. Lampert says the combination will save \$300 mil-

JENNIFER S. ALTMAN

lion annually in costs and add \$200 million to profits by promoting each chain's brands in the other's stores. Kmart also has \$3.8 billion in tax credits carried over from previous losses that should shield profits from taxes for several years. UBS estimates that Kmart will book about \$885 million of that benefit this year. What's more, if the stock price keeps rising, Lampert may preserve much of his cash pile and instead use his super-rated shares, which now trade around \$110, vs. \$15 just 18 months ago, as currency for other dealmaking.

Sears investors also applauded the deal. Sears surged 17%, to \$53 a share. The big winner, of course, is Lampert's private investment fund, ESL Investments Inc. in Greenwich, Conn. It holds 52.6% of Kmart and 14.6% of Sears. Analysts estimate that ESL will hold 42% of Sears Holdings Corp., which will own Sears and Kmart after the merger. Sears shareholders have the option of getting half a share of Sears Holdings for each Sears share, or \$50 in cash. But with Sears shares trading above \$50, investors apparently want to skip the cash and take the new stock. If they all go that way, there won't be enough to go around, so they'll receive up to 45% in cash and 55% in stock.

Either way, Lampert will be forking over a good deal of cash for Sears. Phelan estimates that the combined Kmart-Sears will be down to about \$1.5 billion in cash on hand after the transaction. If Lampert improves the combined retailers' performance, he'll rebuild his cash faster. And he will probably also get higher prices when he offloads marginal stores if he can sell them at a measured pace. Indeed, there may be a lot of upside in Sears Holdings earnings just by squeezing more sales out of Kmart stores. Lampert says Kmart's sales are \$80 a square foot below those of Sears. With Kmart's 100 million square feet of real estate, boosting its sales to Sears' level would create \$8 billion in annual revenue.

So expect the 42-year-old Lampert to focus on making sure the Kmart-Sears combo works—producing the cash and valuable shares investors expect. Like Buffett, Lampert wants to build a reputation as someone who offers sound business advice—a reputation that

would help him team up with executives in future acquisitions.

Lampert, now Kmart's chairman, will become chairman of Sears Holdings. Sears Chief Executive Alan J. Lacy will become vice-chairman and CEO of the new company, and Kmart CEO Aylwin B. Lewis—named to the post just last month—will become president of Sears Holdings and CEO of Sears retail. Combined sales would total \$55 billion and rank Sears Holdings as the nation's third-

counter that trend, Sears has launched its own off-mall concept, called Sears Grand. Kmart helped accelerate that strategy this year when it sold 50 stores to Sears.

In a conference call, Lacy told investors the merger will allow for the conversion of more Kmart's in market where the stores better fit Sears' demographic of slightly higher-income shoppers. He also said Kmart will benefit from cross-selling Sears' major brands, possibly Kenmore appliances, Craftsman tools, and Diehard batteries.

At Kmart, Lampert has defied skeptics who had left the chain for dead. By converting virtually all of its debt to equity in the reorganization, he bought time to turn the retailer around. He has since posted four successive quarters of profits, sold off marginal stores, and reduced inventories. Kmart helped stoke the surge in its stock by disclosing in

SYNERGY The key to success will be winning customers back from bigger retailers



Going Shopping

Why Kmart's purchase of Sears makes sense for financier Eddie Lampert



NOV. 22, 2004

■ Sears' \$2.7 billion in cash will be added to Kmart's quickly rising \$3 billion treasure chest. Cost-cutting will save \$300 million more a year, and cross-promotions between the chains will add \$200 million to profits.

■ Kmart's \$3.8 billion in tax credits carried over from previous losses will shield the merged company's profits from taxes for several years and boost its cash on hand.

■ With 3,500 stores, the new company will hold an immense real estate portfolio, giving it the flexibility to switch stores between the chains and sell stores to raise yet more cash.

■ A successful merger should boost the company's stock, giving the new Sears Holdings a valuable currency for making more deals.

largest retailer behind Wal-Mart Stores Inc. and Home Depot Inc., displacing current No. 3 Target Corp. "We think there is opportunity for a broader customer base and much expanded sales," Lampert says.

Both Kmart, with 1,500 discount stores, and Sears, with 870 mall-based stores, have seen declining sales as shoppers have gravitated to savvy rivals. To

securities filings that it could invest its surplus cash elsewhere—just as Buffett did in the 1960s with Berkshire, then just a declining textile mill in New Bedford, Mass.

Lampert, who always plays his cards close to the vest, isn't saying how he'll use that cash next. Unlike Buffett, he prefers riskier investments that promise a bigger payoff. But he could also place a safer bet by making a play for AutoZone Inc. or AutoNation Inc., in which ESL holds major stakes. Both stocks rose nearly 2% the day of the Sears deal. Buying one of them would let ESL cash out of those investments and move the stakes to Sears Holdings. Legendary value investor Martin Whitman says that even if Lampert keeps investing in Kmart and Sears, he'll still "have a lot of surplus cash" to invest.

Whatever he does next, Lampert is full of surprises. When he was kidnapped last year, he managed to talk his way out of captivity by offering a small fraction of the \$1 million his captors wanted. Investors are betting those deal-making skills will keep making him—and them—lots of money. ■

—By Robert Berner, with Joseph Weber, in Chicago

RETAILING

March of the Toys— Out of the Toy Section



LOADING UP AT HOME DEPOT More playthings are finding their way into novel outlets

The Lego Co. thinks it has found a missing piece of its business. Earlier this year, the Danish toymaker rolled out a low-priced line of its famous plastic blocks.

The new line, known as X-Pod, is sold in drugstores and supermarkets near the candy and magazines at the checkout—with 40 small pieces going for just \$3.49.

"Everybody's feeling the crunch of retail consolidation and looking for alternative places to sell toys," says Michael McNally, a senior brand relations manager at Lego.

Lego is not the only company angling to sell toys in new and different ways this Christmas season. Faced with a shrinking pool of traditional toy stores and the growing domination of the business by giant discount chains, both large and small players in the \$20 billion-a-year toy industry are rushing to stock the aisles of nontraditional outlets. And they're even selling their toys to grown-ups and kids alike wherever possible. Jakks Pacific Inc. has been promoting its new TV Games line of retro video games, including *Ms. Pac-Man* and *Pong & Asteroids*, in clothing stores such as Urban Outfitters. RC2 Corp. is

plowing new ground with a John Deere toy tractor available exclusively at Home Depot Inc., and Screenlife LLC is selling its popular board game *Scene It?* everywhere from Nordstrom to Circuit City Stores.

Even the heavyweights Mattel Inc. and Hasbro Inc., are getting into the game. In a back-to-the-future move, Mattel is trying to market a new line of Barbie clothes at Macy's, which closed its toy department years ago, while Hasbro has repackaged its venerable Play-Doh for sale in arts-and-crafts stores. "This is an industry that needs to find growth wherever it can," says Sean P. McGowan, a toy industry analyst at brokerage firm Harris Nesbitt Corp.

The shift signals a new level of desperation by toymakers as the "big box" retail chains stomp all over traditional retailers. In the past dozen years, Wal-Mart Stores and Target have doubled their share of toy industry sales, to 32%, contributing to the decline

of such retail mainstays as Toys 'R' Us, KB Toys, and FAO Schwarz. Their downfall has been equally bad for manufacturers, who have seen margins get squeezed as a result.

To help gain entry into new outlets, toymakers are developing more exclusive products and packaging. Toy giant Hasbro has been pushing Play-Doh kits that come with cutting tools at arts-and-crafts stores. The Pawtucket (R.I.) company also bundles its new VideoNow personal video players for kids with extras such as headphones, software titles, and carrying cases for sale at warehouse stores, where shoppers are used to paying larger dollar amounts for a greater overall value. The move also helps Hasbro lessen its dependence on just a few customers. "Our mantra is to be anywhere kids and parents are," says Brian Goldner, the president of Hasbro's toy division.

Similarly, Mattel has been rolling out new Barbie boutiques in Macy's, a unit of Federated Department Stores. The boutiques, carved out of the children's clothing section, feature Barbie-themed clothing, accessories, and even a perfume, exclusive to Macy's. Mattel designs and pays for much of the in-store signage, displays, and the newspaper and billboard advertising. The company is even sponsoring a Barbie float in this year's Macy's Thanksgiving Day Parade in New York—a rare event for the 45-year-old doll. "When you see it all fit together, it really makes a statement that we can't make in other places," says Richard Dickson, Mattel's chief of consumer products.

Board-game maker Cranium Inc. is considered a pioneer in these alternative retail outlets. The small toy company, founded in 1998 by a pair of former Microsoft Corp. employees, persuaded Starbucks Corp. to sell its board game, intended primarily for grown-ups. The company has since come out with children's versions of the game, which are now sold at the big discounters. But the company still

tests new products at Starbucks and continues to look for new outlets. This December, Cranium representatives in company hard hats will walk the aisles of Whole Foods Market, handing out brain teasers written on cards to shoppers who'll be able to buy games at the supermarket. To survive in toyland nowadays, you have to think outside the box.

—By Christopher Palmeri
in Los Angeles

THE STAT

32%

Combined retail toy-market share of **Wal-Mart** and **Target**—twice their slice in 1993.

Data: Harris Nesbitt, NPD Group

TECHNOLOGY

TO THE TECH GIANTS GO THE SPOILS

Yes, overall demand is tepid. But buyers now want partnerships with big players

INVESTORS NERVOUSLY CROSSED their fingers as Hewlett-Packard Co. prepared to announce its fourth-quarter earnings on Nov. 16. After all, the company had stumbled so badly three months earlier that CEO Carleton S. "Carly" Fiorina had summarily fired three top sales execs. Analysts had questioned HP's ability to deliver on Fiorina's strategy of providing a comprehensive array of tech products and services for corporations and consumers. So it was a relief when HP announced revenue growth of 8% year over year, to \$21.4 billion, and a 27% jump in profits, to \$1.1 billion. One key to its quick turnaround: strengthening demand from large corporations.

HP's results point to a puzzling disconnect: Most recent surveys of corporate tech buyers signal tepid demand at best. The latest update, a survey of 1,900 companies announced on Nov. 17 by market researcher META Group Inc., showed that they expect their tech spending to rise just 3% this year—half of META's original forecast. Yet, like HP, a slew of tech outfits have reported relatively strong revenue gains in their most recent quarters, including Dell, with an 18% gain; IBM, 9%; Microsoft, 12%; and network-gear maker Cisco Systems, 17%. Sure, they benefited from favorable currency exchange, but what's going on here?

There's a relatively simple explanation:



LONG-TERM LEAP HP CEO Fiorina saw a 35% jump in "managed services"

a flight to quality. These top performers are the largest and most dependable companies in the industry. After the tech bust of 2001, corporations clamped down on tech spending and got much pickier about their suppliers. Out went the cutting-edge small fry, apart from such standout innovators as Salesforce.com and Juniper Networks Inc. In came large, dependable suppliers with broad product portfolios. What's happening now is an intensification of that trend. When corporations started spending more freely about a year ago, they focused on forging tight bonds with a handful of hefty

players. "When you move from tactical cost-cutting to strategic deployments of new technology, you want to have long term partnerships with your tech suppliers," says analyst Mark D. Stahlman of Caris & Co.

A TREND WITH LEGS

ADDING TO THE confusion over demand was the tech sales slowdown over the summer amid rising concern over oil prices and geopolitical risk. Suppliers noted a reluctance by customers to make large buys, and they worried that demand could slide in the second half, especially since the fourth quarter of 2003 was so strong that comparisons would be likely

to hurt. Yet demand held up pretty well, says Intel Corp. President Paul S. Otellini. "Everyone entered the second half very cautiously. But we're seeing normal seasonality."

Details from HP's quarterly report show what's happening. The company reported a 35% jump in its managed-services business—the unit that runs tech operations and data centers for large corporate clients under multi-year contracts. HP's two-year relationship with the Philadelphia Stock Exchange, for example, shows the value of strategic pairings for customers. Using software from HP and Veritas Software Corp., the exchange is finishing automating management of two dozen high-performance servers. "We view these as true partnerships," says Tony Catone, the exchange's director of systems architecture.

This migration to strategic relationships shows no sign of letting up. Of 100 tech purchasers surveyed in October by Merrill Lynch & Co., 75% said they prefer to buy integrated technology packages for their data centers rather than so-called best-of-breed products from a variety of suppliers. And nearly 60% said they would consider having one key supplier. The bad news for HP: Overwhelmingly rival IBM is the first choice.

For next year, most analysts and tech leaders predict modest overall spending growth on the order of 5% to 6%. Other than wireless communications and security software, there aren't many new must-have applications. And you can expect the giants to continue to grab the lion's share of the business. ■

—By Steve Hamm in New York

The Strong Get Stronger

REVENUE GROWTH FOR THE MOST RECENT QUARTER

EMC
34%

DELL
18%

CISCO
17%

MICROSOFT
12%

IBM
9%

HP
8%

Data: IDC



CHIPMAKERS

GETTING INTEL BACK ON THE INSIDE TRACK

CEO-designate Paul Otellini needs to regain ground lost to AMD

FINALLY, INTEL CORP. PRESIDENT Paul S. Otellini got some good news. After a year in which the chipmaker blundered from one execution gaffe to another and rival Advanced Micro Devices Inc. stole the limelight with hot new chips, Intel's directors offered a welcome note of confidence: On Nov. 8, they formally tapped him to succeed CEO Craig C. Barrett next spring.

But there's no time to celebrate. Rival AMD has pulled ahead in the latest generation of server and PC chips. That puts Intel's key partners, Microsoft Corp. and Dell Inc., in an awkward spot: loath to damage long ties with Intel but under pressure to work with a rising AMD. To keep Intel ahead, Otellini has laid out a three-pronged strategy: Package chips together to meet customers' needs, adopt new metrics to ensure manufacturing and execution glitches don't happen again, and improve relationships with Dell and Microsoft. As the CEO-designate told *BusinessWeek* on Nov. 17: "Job One is to get the company growing again."

To achieve that, Otellini will have to change a hidebound engineering culture that has been much criticized for continu-

ing to design microprocessors more for speed than utility. That began to change in 2003, when Intel rolled out Centrino, a so-called platform that combines processors with specialty chips to perform a specific task—in this case, connecting notebooks wirelessly to the Web.

Centrino was a huge hit, and Otellini is determined to adopt the platform strategy in three more potentially lucrative areas: the digital home, handheld computing, and corporate servers. For example, Intel aims to bake features into chips that let companies manage PCs and servers remotely—which could bring huge cost-savings, says Intel. Otellini believes the shift will give Intel a major boost over AMD. "If my theory on platforms is right," he says, "that will be our sustainable advantage."

The big question is whether customers will want combo packages. In September, Intel dropped plans to make its chips capable of wireless Net access without the

OTELLINI "Job One is to get the company growing again"

need for the external base stations now found in many home networks; PC makers weren't interest-

ed in paying extra for it. Furthermore, rivals such as Texas Instruments and AMD contend that many makers of computers and other tech gadgets are leery of getting locked into single-platform solutions. "Customers are going to make sure they keep their options open," AMD CEO Hector Ruiz said in an interview in July.

What's more, the strategy to create chip packages could hurt profits. When Intel ramped up production of the chipsets and motherboards that go into platforms in the third quarter, gross profits slipped to just under 56% from an expected 60% that quarter. Why? Because chipsets and motherboards fetch much lower margins than microprocessors.

Whatever the merits of the platform strategy, analysts say, Intel needs to shore up relations with Microsoft and Dell. In recent weeks, Dell, which uses Intel's chips exclusively, has sounded more serious about using AMD chips. "We've been studying AMD products closely," Dell President Kevin B. Rollins said on Nov. 11. "Some have come a long way." Microsoft, meanwhile, will snub Intel's high-end server chip, Itanium, in an upcoming software update. Otellini "isn't thrilled" about Microsoft's decision, but he says he understands because the Itanium market is not big enough for the software giant. Otellini says relations with Microsoft are the best in a long time. As for Dell, he accepts that

AMD's success in servers has "probably [put] some pressure on them."

That's why catching up with AMD is key. But it won't be easy. Analysts say Intel may be 18 months behind in creating its own technology. What's more, the company has developed a habit of overpromising; that's why Otellini vows to set more reasonable deadlines. He has also started killing nonessential projects so engineers can focus on

getting the new chips right and avoiding manufacturing glitches. Otellini's challenges are clear. If he prevails, he will have proved he deserves his new title. ■

—By Cliff Edwards in San Mateo, Calif., with bureau reports

Otellini's Checklist

■ Boost Intel's flagging growth by delivering products that the market wants

■ Ensure that recent manufacturing and execution glitches don't happen again

■ Convince key partners Microsoft and Dell that Intel has the right products

TECHNOLOGY

WILL SOLARIS 10 MAKE SUN SHINE AGAIN?

The new operating system, while powerful, probably won't jolt earnings on its own

WHEN SUN MICROSYSTEMS Inc. Chairman and CEO Scott G. McNealy took the stage at a shindig in San Jose's Tech Museum of Innovation on Nov. 15, he unveiled the most important product to come out of his company in nearly a decade. Called Solaris 10, it's the latest version of the server maker's flagship operating system and, by most accounts, an impressive piece of technology. Built over four years at a cost of \$500 million, Solaris boosts Sun's technological lead on Linux by increasing the efficiency of the server computers it runs on and making them as heavy-duty as an old mainframe.

But will the new Solaris be enough to light a fire under the long-suffering Santa Clara (Calif.) company? In recent years, Sun has lost customers to low-cost rivals that piece together servers with chips made by Intel Corp. that run on the Linux open-source operating system. That's why cutting-edge software alone won't get the job done. It will take more effective cost-trimming and an improvement in Sun's oft-criticized sales force to convince investors Sun is back on track. "This is going to be a slow process that probably has a lot of bumps along the way," says Laura Conigliaro, a Goldman, Sachs & Co. analyst.

McNealy's rebound strategy reverses Sun's go-it-alone model—build and sell everything from the computer chip to the operating system—that has cost the company dearly. Solaris 10 will work with not



McNEALY His new strategy: monthly fees for support and maintenance

only Sun servers but also rival boxes and chips. That could hurt Sun server sales, but McNealy

has no choice if he wants to keep buyers who like the cheaper, more flexible technology of open-source rivals.

In an effort to convince the marketplace that Sun has changed its approach, McNealy is determined to enforce a cultural shift among his sales force, which had long pushed customers to buy both Sun software and servers. Now, if a customer buys Solaris but runs it on a rival server, the salesperson will be compensated as though she had sold the box, too.

What's more, with Solaris 10, Sun has all

but adopted the pricing model used by top Linux distributor Red Hat Inc. When Solaris ships at the end of January, it will be free for use on lower-end servers.

STEADY DEFECTIONS

SO HOW WILL Sun make money? Like Red Hat, it aims to sell monthly subscription services for things like bug patches and support. For a typical server, that will cost customers about \$1,400 a year. With traditional software sales, customers pay for everything up front. By contrast, Sun will likely see sales on a monthly basis. That should smooth out earnings.

The pricing model is an effort to stop customer defections to Linux. As Sun Pres-

ident Jonathan I. Schwartz acknowledges, the bulk of the \$2 billion annual market for servers that run on Linux, up from near zero five years ago, came at Sun's expense. Sun's share of the \$45 billion server market has dropped 5.5 percentage points since 2000, to 12.5%, according to researcher IDC. IBM, whose servers run its own OS and Linux, leads the market with a 32% share.

It won't be easy to get customers back from Linux clutches. Switching operating systems is notoriously difficult. Zachary A. Nelson, CEO of Web-services company NetSuite Inc., won't buy Solaris. "It's difficult to get

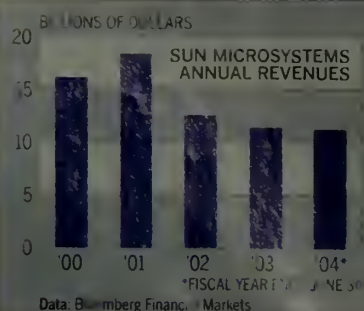
back in there and monkey with the operating system," says Nelson. He's sticking with Linux. Yet Sun's newfound flexibility has an upside: Nelson plans to replace his 30 Hewlett-Packard servers with Sun boxes.

Given Sun's low-price approach to the market and the continued threat from low-cost rivals, keeping expenses down is crucial. McNealy figures he can reduce Sun costs by \$500 million in the fiscal year ending in June, 2005, via layoffs already under way and cheaper computer-component prices.

Will it all be enough to turn Sun around? After three years of decline, Sun has had two quarters of single-digit sales growth. And in the quarter ending Dec. 31, the company is expected to generate \$8 million in net income, although much of that will come from cost-cutting. It could be a year or more before investors know whether Sun is in the middle of a hard-fought return—or a tech giant that couldn't change with the times. ■

—By Jim Kerstetter in San Mateo, Cal

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PHARMACEUTICALS

LESSONS FROM THE VIOXX FIASCO

What drugmakers, the FDA, doctors, and patients need to do

WHAT A MESS. WEEKS AFTER Merck & Co. yanked its blockbuster painkiller Vioxx off the market, the furor is still raging. How could a drug get to \$2.5 billion in annual sales despite evidence that it caused heart problems? The company faces personal-injury lawsuits that could cost it billions. The Food & Drug Administration has been widely criticized for its role in assessing Vioxx, and the agency is scrambling to improve its system for catching

problems with drugs after they're approved. And Congress is holding hearings to try to figure out who's to blame.

Yet despite the finger-pointing, the fact remains that all drugs have risks, and even the most dangerous can have benefits for some patients. Indeed, some Vioxx users are threatening to sue to get it back on the market. It's a complex story with no black-and-white answers. Here are some of the key questions:

How did this happen?

Even before Vioxx was approved by the FDA in 1999, scientists wondered if it could cause heart problems or stroke. The trials used to win approval didn't raise red flags, but a subsequent study did: Merck found in 2000 that more than twice as many patients had heart attacks when taking Vioxx than when given an older painkiller, naproxen. But it made the questionable argument that the difference was due to protective effects of naproxen, not to a problem with Vioxx. The FDA did add a mild warning to the label, but that didn't stop the drug from being widely used.

When Merck then compared Vioxx to a

placebo in a long-term study of patients at risk for colon cancer, the rise in heart attacks was clear. Vioxx was pulled on Sept. 30.

So who is responsible?

There's plenty of blame to go around. Vioxx' big benefit compared with older painkillers such as ibuprofen is that it causes fewer cases of stomach bleeding. But that's a problem for only a small percentage of patients. And thanks to an advertising blitz by Merck, its new drug became a best-seller, used by hundreds of thousands of people who didn't really benefit from its one advantage.

Meanwhile, Merck downplayed evidence of heart problems, including worrisome findings from an unpublished study. And the FDA didn't take initial warning signs seriously enough. "It would have been appropriate to put a black-box warning [on Vioxx' label] or stop the direct-to-consumer advertising until this was sorted out," says Dr. Eric J. Topol, chief of cardiovascular medicine at the Cleveland Clinic.

Are these issues unique to Vioxx?

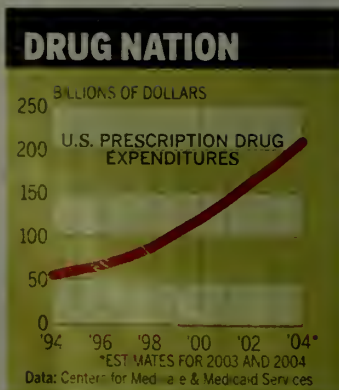
Sadly, no. Even though the FDA is often

criticized for requiring so much safety and efficacy data that drug development is long

and costly, the truth is that the approval process never picks up all the side effects—or benefits—of a drug. Five years after the approval of any drug, "we don't know all of the harm," says Dr. James M. Wright, a professor of pharmacology at the University of British Columbia. "And there is always harm—especially with potent drugs that have real benefits." Some doctors even suggest steering clear of most new drugs for seven years.

Drugmakers, of course, want to make as much money as quickly as possible. They spend \$3 billion a year advertising their newer drugs directly to consumers. That can be good since it often prods people to go to their doctors. But the ads lead to unrealistic expectations about the benefits of drugs while minimizing risks. Often obscured in the advertising frenzy is the simple truth that many health problems are better solved by a change of diet or lifestyle than treatment with drugs. The result is that medicines are often overused. From 1993 to 2003, the number of prescriptions purchased rose from 2 billion to 3.4 billion, a 70% leap, according to the Henry J. Kaiser Family Foundation. That has led many health-care ex-

LABEL BABEL The FDA's too-mild heart alert on Vioxx was widely ignored



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perts to worry that the U.S. has become an overmedicated society.

Drugmakers don't put the same muscle behind highly beneficial older and cheaper drugs, such as diuretics for high blood pressure. So those drugs are underutilized. Plus, companies tend to bury data from trials that show safety problems, says Dr. Joseph Lau, a professor of medicine at Tufts University. "The problem is that doctors often don't have the right information," he says.

Doctors aren't doing the best job, either. Studies show that many simply don't heed even the sternest warnings issued by the FDA. When patients taking the diabetes drug Rezulin from the former Warner-Lambert Co. (now Pfizer) started dying from liver failure in the late 1990s, the FDA repeatedly warned doctors to carefully test patients' liver enzyme levels to spot early signs of trouble. Yet fewer than 5% of patients got the tests, and more people died.

Are there solutions?

Yes. For starters, we need better data about benefits and risks. As a condition of approval for many drugs, the FDA should require that companies collect data on patients receiving treatment or do additional clinical trials. Drugmakers are willing, especially if it means getting their product to market. Finding out more about newly approved drugs "is something we should enter into almost as a contract," says AstraZeneca PLC CEO Sir Tom McKillop. The FDA also must require clearer information about risks and benefits on drug labels. And someone—probably the government—must pay for large trials that compare new drugs to older ones.

Beyond that, society needs to understand that drugs are a double-edged sword. Doctors should do a better job of keeping up with pharmaceutical findings. And patients should know that all medicines are potentially dangerous and should be used cautiously. In the past, "people accepted that there was no such thing as a totally safe drug," says McKillop. "Today we have become much more risk-averse." Adds Dr. Mary H. Parks, a top FDA drug-approval official: "Even in the best case, with full due diligence, we will never know everything about a drug." That's why it will always be a struggle to hit just the right balance between help and harm. ■

—By John Carey in Washington and Amy Barrett in Philadelphia, with Carol Marie Cropper in Atlanta

COMMENTARY

BY CATHERINE ARNST

Big Pharma's Blinders

The blockbuster mentality crimps innovation

THE PHARMACEUTICAL industry portrays itself as a champion of innovation. That seems reasonable given that U.S. drug companies spent \$33.2 billion on research and development in 2003, almost 18% of their domestic sales. Yet for all that spending, Big Pharma appears remarkably risk-averse compared to the armada of small biotech companies that increasingly produce the most novel drugs. Why? It's all about the type of organizations that large drugmakers have become. Hugely profitable thanks to a few blockbusters, Big Pharma is far too focused on looking for the next best-seller.

That means spending lots of development dollars on relatively safe bets, such as statins, the cholesterol-lowering drugs taken by millions. It's worth it for Big Pharma to invest \$800 million or more to develop a new statin drug even if several are already on the market. After all, Pfizer Inc.'s Lipitor and Merck & Co.'s Zocor are similar statins—and the world's two biggest-selling drugs.

But Big Pharma's focus on finding the next heart blockbuster means it is passing up an opportunity to deliver important breakthroughs. Compare the industry's strategy to that of biotech companies. They focus on cancer drugs because those tend to be more narrowly targeted and so are less expensive to test. Because biotechs are exploring new targets, four breakthrough cancer drugs

have reached the market in the last three years. The tally for heart drugs: zero. "Biotech is typically more aggressive in working on novel technologies," says Robert Tepper, head of R&D of Millennium Pharmaceuticals Inc.

Big Pharma's less aggressive approach was on full display in early November, at the American Heart Assn.'s Scientific Sessions in New Orleans. There were virtually no new heart drugs highlighted at this year's meeting.

To be fair, developing a new blockbuster is hardly risk-free. Some 75% of experimental treatments fail in clinical trials, so it takes a strong constitution to spend \$800 million on a completely new heart drug. And precisely because huge numbers of people will be taking them, heart drugs in particular face tough scrutiny from regulators. There is also the danger demonstrated by Merck's Vioxx, that a new drug taken by millions could eventually cause side effects, leading to crippling



BUSY BIOTECHS

Four breakthrough cancer drugs in three years

class actions. Consequently, the only significant new heart drug in the past two years is AstraZeneca PLC's Crestor—another statin.

The outlook for heart drugs could improve in the next few years thanks to some new approaches now being tested. Pfizer is in late-stage trials with a drug that combines a statin with a drug that raises levels of "good" cholesterol, while GlaxoSmithKline PLC is developing a drug meant to stop the inflammation that plays a key role in atherosclerosis. Those are encouraging signs. The sooner Big Pharma starts getting more creative, the better. After all, the world doesn't need another statin. ■



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STRATEGIES

WHY KRAFT IS ON A CRASH DIET

With private labels eating into share, the CEO wants its brands either No. 1 or gone

KRAFT FOODS INC. SURE has bulked up. In the past five years, the company has gobbled up 10 rivals, including Nabisco Holdings Corp. for \$19 billion in late 2000. The result: the biggest packaged-food maker in the U.S., with expected 2004 sales of \$32.3 billion and products in almost every aisle of the grocery store, from Kraft cheeses and Oreo cookies to Oscar Mayer meats, Post cereals, DiGiorno pizzas, and Maxwell House coffees.

Now Chief Executive Roger K. Deromedi has decided it's time for Kraft to slim down. He began with the Nov. 15 sale of Kraft's Life Savers and Altoids candies to Wm. Wrigley Jr. Co. for \$1.5 billion in cash. And more will follow, he says, as Kraft divests itself of other laggard and peripheral product lines to concentrate on the blockbuster brands that can be tops in their categories worldwide. Says Deromedi: "We want the products that consumers and retailers are more excited about."

Clearly, the pressure is on the 51-year-old Deromedi, who became Kraft's sole CEO a year ago, when Co-Chief Executive Betsy Holden was demoted to global marketing president. Like other consumer-goods companies, Kraft is scrambling to give Wal-Mart Stores Inc. and other retailing giants what they want. Bulking up to gain leverage with the retail behemoths fueled much of Kraft's expansion in the first place, but that strategy hasn't worked. With Wal-Mart and others increasingly interested only in the briskest-selling products, it turns out that suppliers are better off with a clutch of category killers than a cartful of so-so sellers.

But dealing with Wal-Mart isn't Kraft's only problem. Many are of its own making, from turmoil within its executive suite to oversaturating store shelves with



IN AND OUT
Deromedi may snap up more brands as others go

too many variations of the same old product. How many different kinds of Oreos do consumers really want? At the same time, other consumer-products companies, notably Procter & Gamble Co., have been far more skillful in navigating the

retailing shoals with nifty new product. What's more, management at Kraft's parent, Altria Group Inc., is putting the squeeze on Kraft to shape up in advance of a possible spin-off of its controlling stake next year.

CARB LOADS

WHILE INVESTORS generally endorse Deromedi's new focus, trimming the weakest links alone won't be enough. He will also need to bolster sales and margin at the brands he keeps to lift Kraft from profit slump that goes back to 2003. That won't be easy. Private-label brands are undermining Kraft's ability to charge premium prices, and the consolidating retail sector leaves Kraft with fewer outlets. At the same time, many of its staples, such as Nabisco cookies and crackers, are verboten under low-carb diets, while its own low-carb alternatives haven't scored.

But Deromedi says the asset sales will help. Already, the Northfield (Ill.)-based company has bumped up its 2004 marketing budget by some \$550 million, swelling outlays on marketing, administration, and R&D to more than \$6.5 billion. And as Kraft raises more money, Deromedi promises to further boost spending on advertising and product development, such as its new DiGiorno microwaveable pizzas. Says Deromedi: "Where we think we can win is the key."

Now Deromedi is evaluating which brands to auction off next. As with the sale of Altoids and Life Savers to Wrigley, he'll look at secondary brands or those where Kraft lacks the clout with retailers to turn things around. Analysts and consultants figure Oscar Mayer is most likely. Despite being the leader in bacon, hot dogs, and luncheon meats in the U.S., with \$2.1 billion in annual sales, it has been losing out to cheaper store brands and has little brand recognition overseas. Kraft's \$1.2 billion-a-year Post cereals division, a distant No. 3 that also is ceding market share, could also be on the block. Michael A. Crowe, a senior managing director of Mesriow Financial, which owns 200,000 Kraft shares, hopes the sales come soon. "It's not long overdue," he says. "But it is overdue."

Long-term, of course, Deromedi cannot make Kraft grow by slimming down. In fact, he says he might take some proceeds from divestitures and make acquisitions. But for now, it seems, Kraft may do well to drop a few more pounds. ■

—By Michael Arndt in Chicago

A Lot to Lose

After unloading Altoids and Life Savers for \$1.5 billion, Kraft may soon shed other brands. Among them:

	ANNUAL SALES MILLIONS	POTENTIAL PRICE BILLIONS
Post cereals	\$1,160	\$3.0
Oscar Mayer meats	2,150	3.4
Light 'n Lively and Breyer's yogurts	162	NA
Stove Top, Baker's, and Shake 'n Bake cooking supplies	365	NA

Data: Lehman Brothers, ACNelson

Three of the "25 best funds"*

-Kiplinger's, May 2004

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Figures as of 9/30/04.

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Equity Income Fund Invests in the common stocks of established companies that are expected to pay above-average dividends.	18.89%	5.96%	11.99%
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EDITED BY MONICA GAGNIER

HEADLINER

ROBERT NARDELLI



HANDYMAN SPECIAL

Robert Nardelli's first three years as chief executive of **Home Depot** were painful. Overzealous cutbacks in inventory led to out-of-stock items. Customers complained about poor service. By the end of 2003, investors had sent Home Depot's stock tumbling 13%.

Still, Nardelli stuck to his vision for Home Depot's comeback: bank on aging baby boomers sprucing up their empty nests, renovate outdated stores, expand into international markets such as Mexico, add high-margin appliances, and roll out installation services.

Now Nardelli's gritty determination is paying off. In the third quarter, sales jumped 13.1%, to \$18.8 billion. Home Depot has raised 2004 profit growth goals to 19% to 20%, from 10% to 14% at the start of the year. "Facts are friendly," says Nardelli. Although the company must still fend off inroads from archrival **Lowe's**, for now Nardelli has Home Depot humming like a powerful profit generator.

—Brian Grow

CLEANING UP A PENSION MESS

On Nov. 15, the troubles of the U.S. pension system doubled. That's when the **Pension Benefit Guaranty Corp.**, a government-backed insurer of private pension plans, announced that its deficit had jumped from \$11.2 billion last year to \$23.3 billion, due largely to trouble at airline pension plans. Several lawmakers quickly called for a legislative fix in 2005. Among the reforms that experts are hoping to see: new tax rules that allow companies to contribute more in good times without penalty, more transparent and accurate reporting, penalties for plans that are underfunded, and more conservative investing by fund managers. pbgc Executive Director Bradley Belt last month warned that taxpayers could face a bailout of the pension system akin to the savings and loan rescue of the late 1980s.

GOOGLE KEEPS GALLOPING



Since navigating its turbulent initial public offering in August, **Google's** stock has seemingly defied gravity. So far, the release of millions of shares to public markets has made only minor dents in **Google's** stock price. On Nov. 16, the lockups expired on 39

million shares held by **Google** employees and investors—a deadline that some analysts feared would hammer shares in the search giant. But **Google's** stock sank a mild 6%, to \$173—still 104% above its ipo price of \$85. Even so, the danger to this buoyant stock isn't over yet: In February, employees and investors will be free to trade an additional 177 million shares now locked up.

FANNIE: PRICEY PAPERWORK

The bad news doesn't stop at **Fannie Mae**. On Nov. 15, Fannie said it may have to report a \$9 billion loss if required to restate results back to 2001. In September, the **Office of Federal Housing Enterprise Oversight** concluded that the housing finance giant failed to account properly for derivatives used to hedge interest-rate risk. The regulator argued that Fannie must deduct any losses in the value of those derivatives from its earnings. If the **Securities & Exchange Commission** requires a restatement, Fannie's capital would decline by \$9 billion, forcing it to issue stock, sell mortgages from its portfolio, or pare debt. Fannie also missed a deadline for filing third-quarter results because its auditor, **KPMG**, can't complete its review until the sec finishes its investigation.

SBC: LIGHTS, CAMERA...

SBC Communications moved closer toward launching tv service on Nov. 17 by agreeing to pay \$400 million to **Microsoft** over 10 years for technology to deliver video over broadband pipes. The deal should help sbc battle cable operators muscling in

on its telephone turf. It's also a win for **Microsoft's** tv biz. The service, which will allow customers to choose from thousands of tv shows on demand, will launch by late 2005. sbc expects to make it available to 18 million households by the end of 2007.

ET CETERA...

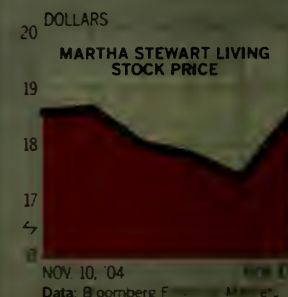
»»The founders of **PBHG Funds** agreed to pay \$160 million to settle charges of improper trading.

»»**Philips Electronics** will write off \$753 million for its health-care unit **MedQuist**.

»»**Wal-Mart Stores'** third-quarter net income rose 12.7% on a sales gain of 9.7%.

CLOSING BELL

Finally, some good news for **Martha Stewart Living Omnimedia**: The \$11 billion **Kmart-Sears** merger gives it a much bigger retail reach. The prospect of **Sears** customers snapping up **Martha Stewart** Everyday gear sent **MSO** shares up 6.3%, to \$18.49.





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Hope, Triumph, and the Miracle of Medicine

BY RICHARD S. DUNHAM

Did Hispanics Really Surge to Bush?

IT INSTANTLY BECAME PART of American political legend: President Bush received a hefty 44% of the Hispanic vote on Nov. 2, up sharply from the 35% he garnered in 2000. Pundits credited the Latino surge to the GOP—as measured by two sets of media exit polls—for Bush's wins in such battleground states as Florida, New Mexico, and Nevada. Sounds impressive. But is it true?

Some Democrats and Hispanic activists say it's not. The William C. Velasquez Institute, a nonpartisan think tank, conducted its own exit polls, which found Bush winning 34% of the Latino vote—no better than four years ago. "Bad science is being used to misrepresent a community," says Robert Aguinaga, research director of the institute. Republicans who derided the media polls on Election Day—when they showed Democrat John Kerry running ahead of Bush—are now embracing them.

In fact, none of the polls appear to get the Latino vote right. *BusinessWeek* examined real election returns from 62 jurisdictions in 13 states—mostly places where Hispanics made up 75% to 85% of the population. The bottom line: Bush improved on his 2000 performance in 5% of these heavily Hispanic areas, undercutting Dems' claims that he didn't make inroads. But his gains averaged just three percentage points—far less than the nine-point gain Republicans have been trumpeting.

Given those relatively small gains, it seems unlikely that Bush could have jumped to 44% of the national Hispanic vote. The President polled just 16% in Philadelphia's overwhelmingly Hispanic 7th Ward, and he took just 12% of the vote in Chicago's 22nd Ward, which is 91% Latino. He did better in suburban areas but usually scored in the low 40s. Bush's greatest appeal was to rural Hispanics: He took 60% or more of the vote in several heavily Latino counties in South Texas and averaged 41% in the counties along the U.S.-

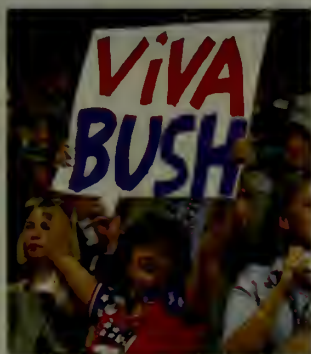
Mexico border. And he carried a majority of the Hispanic vote in Florida, although his percentage declined in Cuban-American precincts in Little Havana and Hialeah.

Missing Conservatives

WHERE DID THE DUELING exit polls go wrong? Velasquez Institute statisticians say the media polls interviewed too many suburbanites. And Democratic pollster Sergio Bendixen posits that the institute focused too much on the barrios. The researchers defend their methodology. "We stand behind the [44%] number," says Warren J. Mitofsky, who performed one of the widely quoted exit polls for the big-media National Elections Pool. Furthermore, Mitofsky suggests that the *BusinessWeek* study—which included a cross-section of Hispanic locations, from the inner cities of the North to the rural Southwest, from suburbs to the farm belts of Washington state and Kansas—missed conservative Hispanics living in predominantly Anglo areas.

Bush advisers say privately they don't believe the President reached 44% of the Latino vote. But that's not stopping them from trying to build on the momentum generated by the post-election buzz. Bush has moved quickly to consolidate any gains among Hispanics (see Capital Wrapup).

The message from *BusinessWeek's* numbers is sobering for Democrats. The party is counting on Hispanic population growth to carry it back to power. But the Dems have lost ground among Latinos in each election since Bill Clinton won 72% in 1996. To turn things around, Democrats will have to do more than attack exit pollsters. ■



CONVENTIONEER
A *BW* study shows Bush's gains were modest

CAPITAL WRAPUP

IMMIGRATION: BUSH'S NEW PUSH

IT WAS DIFFICULT to escape the ballyhoo over Republican gains among Hispanics on Election Day, and President Bush wasted no time in trying to solidify that standing. Within days he appointed the nation's first Hispanic Attorney General and signaled his intent to revive an immigration liberalization plan.

Alberto R. Gonzales, Bush's pick to head the Justice Dept., is likely to win easy confirmation. But Bush's plan to reform the nation's broken immigration system will be a harder sell. Because it would allow some undocumented immigrants to win legal status, it faces resistance on the Right.

"Bush is sticking his thumb in the eye of his base," says Mark Krikorian, executive director of the Center for Immigration Studies.

Backers of the Bush plan say the debate will engender goodwill among Hispanics. But Bush will need to expend enormous political capital to prevail. House leaders are skeptical if not downright antagonistic, saying the plan would cost Americans jobs and increase demand for social services. "Find me a poll that tells me Americans support amnesty," snaps Representative Tom Tancredo (R-Colo.). "You can't, because they don't exist."

The smart money says Bush will husband his political capital for tax cuts and Social Security reform. By raising his voice on immigration but not forcing the issue, he could win Latino hearts—without alienating allies who strongly disagree.

—Lorraine Woellert



AUTOS

DAEWOO: GM'S HOT NEW ENGINE

The once-bankrupt Korean carmaker is one of the brightest spots in the Detroit giant's empire

REMEMBER DAEWOO MOTOR Co.? It's the Korean auto maker that hired college kids to hawk its cars, built factories in unlikely locales such as Uzbekistan, Vietnam, and Ukraine, and once tried to woo British buyers with an offer of a free trade-in for a new model after just six months of own-

ership. Daewoo invested billions building a global capacity of some 2 million cars annually—a number it never even got close to producing—before collapsing under more than \$16 billion debt in 1999. Production plunged by half, 7,000 workers lost their jobs, and scores of suppliers went belly-up.

End of story? Hardly. Today, Daewoo is back, under new ownership, and is rolling

like never before. Since General Motors Corp. bought a controlling interest in bankrupt Daewoo in October, 2002, the rechristened GM Daewoo Auto & Technology Co. has emerged as one of the most promising spots in the Detroit carmaker's empire. Even as Korea's home auto market has contracted by 30% over the past two years, GM Daewoo's sales are soaring. In the first 10 months of this year, it exported

632,000 cars and kits for assembly elsewhere, up 90% from the same period in 2003. It'll be tough to match that performance, but the company expects double-digit growth for several years to come. Although GM Daewoo declines to provide financial details, execs say the company remains in the red but that the earnings picture is improving rapidly. "We are confident we will achieve stable financial health and self-sustainability," says Joseph G. Peter, chief financial officer at GM Daewoo.

In fact, GM's Korean subsidiary is becoming a linchpin in its plans for global expansion. GM Daewoo's cars are sold in more than 140 countries. Across Asia, they have helped increase GM's market share to 5.2%—up from 4.2% two years ago. And in Europe, the company's five models are being pitched as high-quality,

ROLLOUT GM Daewoo in Korea sees double-digit growth

low-cost alternatives to local brands. The Korean operation "gives General Motors the opportunity to truly grow sales in Asia and in the value-market segments in Europe," says Alan S. Batey, chief of GM Daewoo's marketing.

Just don't look for the Daewoo name. In most markets outside Korea, it's being phased out in favor of GM's Chevrolet marque—a brand GM usually pitches as more American than the Stars and Stripes. Since last year, Daewoo's Kalos compact has been marketed as the Chevrolet Aveo in the U.S., Latin America, and Eastern Europe. The Aveo, which starts at about \$10,000, has been the best-selling low-end compact car in the U.S. for the past three months, beating out

such rivals as the Hyundai Excel and the Toyota Echo. Today the cooperation is being stepped up, and Chevys sold in both Europe and Asia will come almost exclusively from GM Daewoo's factories. "No one but GM could have pulled off such a rapid recovery in sales for Daewoo," reckons Hanwha Securities Ltd. analyst Ahn Soo Woong.

GM knew the territory. The company owned half of Daewoo for 20 years, but in 1992 bailed out over management differences. A decade later, after Ford Motor Co. took a pass on the bankrupt Daewoo, GM looked more closely and decided the company was worth the risk—especially at the final price of just \$400 million. GM thought that combining Daewoo's small-car smarts with GM's engineering and distribution could be a winning formula.

For their money, GM and two partners got 70% of an operation that included two modern factories capable of making a total of 475,000 vehicles a year and the company's smaller facility in Hanoi. It also has an option to purchase an older plant in Bupyeong, just west of Seoul, with an annual capacity of 405,000 cars. GM says it hopes to buy the plant by 2008 but has demanded that managers at Bupyeong boost productivity by at least 4% annually and improve quality to GM's global average—conditions the plant has so far fulfilled.

ATTITUDE CHANGE

CONSIDERING THE bargain-basement price, GM execs say they were "pleasantly surprised" by what they found at Daewoo. GM imported its production, supply, quality control, and information technology systems, but the workers needed relatively little retraining. Having

seen the layoffs after the company's collapse, the remaining laborers were quick to adapt to the cost-cutting and efficiency-boosting measures GM implemented—especially as exports took off. "Our attitude has changed to 'our factory' from 'their factory,' and we saw our sacked colleagues returning as we got more work to do," says Kim Sang Hyun,

The Chevy name will replace Daewoo in Europe next year

production manager at the Bupyeong plant.

The big test will come next year in Europe—GM Daewoo's biggest market. That's when all of GM's Korean-made cars will shed the Daewoo nameplate in favor of Chevy, which is being positioned as an entry-level marque that will feed into GM's more mainstream Opel brand. A big part of

GM's thinking is that the Daewoo name is too tarnished to be buffed up as a European sales machine. Another consideration is that former Daewoo partners in Eastern Europe share the brand. The potential downside: "If Daewoo does too well, it could nip at the heels of Opel," says Colin Couchman, an analyst at researcher Global Insight Inc. in London. GM officials say that won't be a problem and that the Chevy models should give the company a lift in Eastern Europe. "Over time, the Opel brand won't have to cover every market segment," says GM-Europe Chairman Frederick A. Henderson.

Now, GM is retooling much of Daewoo's lineup. It has set aside \$1.5 billion to build new transmission and engine plants and to develop a string of new models to be rolled out over the next two years. The first, a new Matiz minicar, is due out in Europe and Korea next spring. In 2006, GM Daewoo is planning a diesel-powered sport utility vehicle code-named S3X. And next April it's planning to unveil a new model at the Seoul Motor Show but hasn't released any details.

Despite the progress GM Daewoo has made, it could still face some headwinds. The biggest challenge remains its home turf. Although GM Daewoo has maintained its 9.5% share even as overall sales in Korea have hit the skids, that remains far below the 33% share Daewoo had in its heyday. Exports also could get nicked by the stronger Korean won, which has gained 9.4% against the dollar this year. And GM Daewoo faces rising labor costs. After boosting pay by 13.5% last year, this year it granted workers an 11% hike to put an end to a weeklong strike.

With GM reeling in the U.S. under the weight of pension and health-care costs, Daewoo will have to stand on its own feet. But shipments keep going up—and the old Chevy nameplate could prove the unlikely rescuer of a troubled Korean brand. ■

—By Moon Ihlwan in Seoul, with Gail Edmondson in Frankfurt and David Welch in Detroit

UPSHIFT

Since GM took over in 2002, Daewoo has made a strong recovery



DRUGMAKERS

'A VACCINE EVERY WOMAN SHOULD TAKE'

Merck and GSK are closing in on shots for HPV, the leading cause of cervical cancer

IT'S THE SECOND MOST COMMON cancer among women, with more than 270,000 deaths reported each year worldwide. For the past decade, Britain's GlaxoSmithKline and its American rival, Merck & Co., have been racing to develop a vaccine against the human papilloma virus (HPV), which causes almost all cervical cancer.

On Nov. 12, GSK's experimental vaccine Cervarix got a boost. A study in British medical journal *The Lancet* reported Cervarix was the first vaccine to be 100% effective in protecting women against two strains of HPV that are linked to more than 70% of cervical cancer cases. GSK has announced it will file for approval for Cervarix in Europe and countries outside the U.S. in 2006, two years ahead of schedule. "Over the last 20 years there has been nothing else developed that will make such a huge impact on women's health," says Dr. Diane Harper, a director of gynecological cancer-prevention research at Norris Cotton Cancer Center in Lebanon, N.H., and the author of the GSK-funded study.

The potential could be huge. HPV is the most common sexually transmitted disease worldwide, infecting 75% of sexually active women at some point. For the majority of women who contract HPV, the body's defenses are enough to beat the virus. Some strains cause genital warts, which

pose no health risk. But persistent infections from others can lead to cervical lesions that ultimately turn cancerous. There is often an interval of up to two decades between infection and cancer. With that in mind, both GSK and Merck think young girls should be vaccinated before the onset of sexual activity.

In the U.S., deaths from cervical cancer are relatively low, but the costs of screening for the HPV virus and treating infections and cervical cancer add up to \$6 billion a year. An estimated 80% of deaths

from cervical cancer occur in the developing world, where pap tests and cancer screening are rare. Poor countries fighting mass killers from AIDS to malaria may be hard-pressed to pay for this vaccine however. Public-private partnerships such as those that have emerged to treat HIV, could help defray costs.

Both cervical-cancer vaccines operate on a similar principle (table). Still, there are crucial differences. While Cervarix targets two cancer-causing strains of HPV, Merck's shot will also ward off genital warts in men and women. Merck, which began phase II efficacy trials a year ahead of GSK, reckons it will be ready to file its vaccine for U.S. approval by the end of next year. Because Merck's vaccine has been in trials longer than GSK's, the company has been able to show a greater reduction in precancerous lesions, a condition the FDA is thought to consider necessary for approval.

MORAL HURDLES

GSK CEO JEAN-PIERRE Garnier figures there is room for both companies. "It's a vaccine every woman should take," he says. Analysts say the market could be worth more than \$3 billion annually by 2008. "This is groundbreaking stuff,"

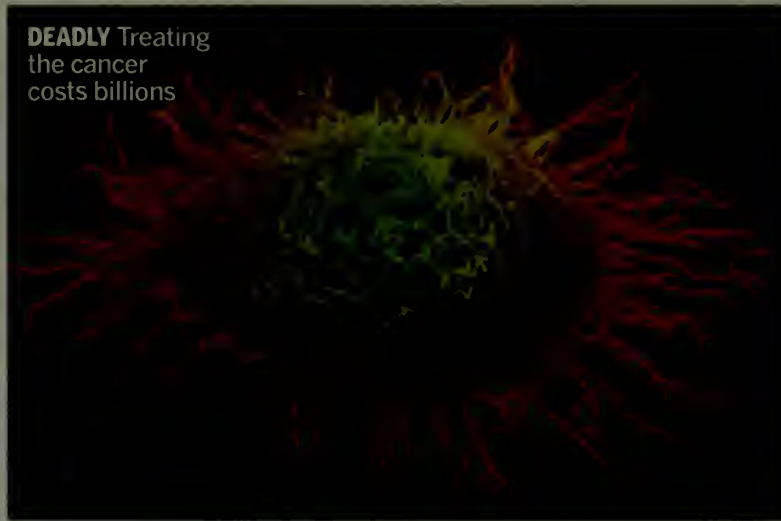
says Adrian Howd, pharmaceutical analyst with ABN Amro in London.

Both companies need the vaccine to succeed. GSK lost two of its best-selling drugs to generic competition, and it will be at least two years before any of its most promising new medicines hit the market. Merck is desperate for good news after it pulled painkiller Vioxx from the market in September.

Despite the health benefits, the shots may not be an easy sell. "The biggest problem for companies will be convincing society of the need to vaccinate young girls against what is essentially a sexually transmitted disease," says Dr. Anne Szarewski, a clinical consultant conducting phase III trials of Cervarix at Margaret Pyke Centre in London. Women worldwide had better hope that Merck and GSK succeed. ■

—By Kerry Capell in London, with Amy Barrett in Philadelphia

DEADLY Treating the cancer costs billions



A Killer Defense

Here's how GlaxoSmithKline's vaccine was developed—and how it will protect against HPV

Data: *GlaxoSmithKline*

1 Scientists isolate a gene from two different strains of the human papilloma virus, HPV 16 and HPV 18. These strains are linked to 70% of all cases of cervical cancer.

2 Gene is introduced into cells, which act as a factory for producing protein.

3 As protein is produced, it spontaneously forms particles that mimic HPV, with one key exception: They have no infectious DNA.

4 Once particles are injected into the body, the immune system is stimulated to produce defenses against HPV 16 and 18.

BY JOHN ROSSANT

France's Industrial Power Trip

Paris can't stop interfering with the economy—and that's bad news for Europe

IN SO MANY WAYS, French politician and presidential aspirant Nicolas Sarkozy is a breath of fresh air in French and European politics. At 49, he's a generation younger than most of France's top politicians. In contrast to the default anti-American attitudes of much of the French elite, Sarkozy underscores his admiration of the U.S. He wants to promote entrepreneurship, boost labor flexi-

bility, and cut taxes. But when it comes to interfering in the French economy, Sarkozy is as old-style as they come.

In fact, by the time he leaves the Finance Ministry on Nov. 28 to head France's ruling center-right party, Union for a Popular Movement, Sarkozy will have presided over some of the most intensely interventionist actions since French Socialists nationalized the country's large banks and industrial groups in 1982. From forcefully chaperoning the merger of two French pharmaceutical giants to shoring up ailing engineering group Alstom, Sarkozy has been giving new meaning to the old concept of *dirigisme*. A great country like France, Sarkozy recently told workers at state-subsidized shipyards, "couldn't just have banks, insurers, and tourism."

Unfortunately, the traditional French sport of picking national champions is not likely to recede once Sarkozy departs the Finance Ministry. True, the headline-craving politician loves to play to the French electoral galleries. But there are other powerful forces behind the latest outbreak of French *dirigisme*. For one, it's a way to react to the in-your-face political assertiveness coming out of Washington. As President Jacques Chirac tirelessly reminds listeners, Europe has to stand up as a "counterweight" to the U.S. And if Europe wants to compete successfully with the U.S. on the world stage, it requires corporate giants of its

own. It's a belief shared by many beyond France. "Europe needs industrial champions," says Europe's incoming Industry Commissioner, Guenter Verheugen of Germany.

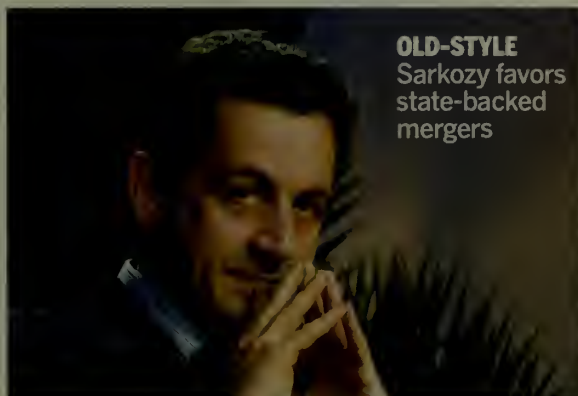
The problem is that "European champion" in the French language invariably seems to translate as "French champion." Earlier this year, Paris was so eager to make sure the country could boast a world-class pharmaceutical giant, it forcefully brokered the \$70 billion takeover of Franco-German Aventis by Paris-based Sanofi-Synthelabo. Aventis' German board members were ignored. At the same time, the French government made it clear that Switzerland's Novartis would be unwelcome. Similarly, earlier this year, Germany's Siemens was told it wouldn't be a welcome bidder for Alstom's railway operations, which manufacture the renowned high-speed TGV trains. That

led German Chancellor Gerhard Schröder to rebuke Paris publicly.

The pace has only intensified. In late October, Sarkozy blessed the coupling of French telephone-equipment maker Sagem with aircraft engine maker Snecma—a \$9 billion merger virtually devoid of industrial logic. Then in early November, news leaked that Franco-German aerospace giant EADS—with Sarkozy's support—was examining a takeover of Thales, a French defense-electronics group with \$14 billion in sales.

Such a deal would make some economic sense, since EADS is overly reliant on its Airbus civil aviation unit for profits and has been looking to bulk up its military business. Yet if the two were to merge, the bigger entity would become largely a French concern, throwing off EADS' delicate French-German balance. Although Sarkozy insists that France would respect the principle of equal French and German control of EADS, the Germans are "furious," according to one banker close to the talks.

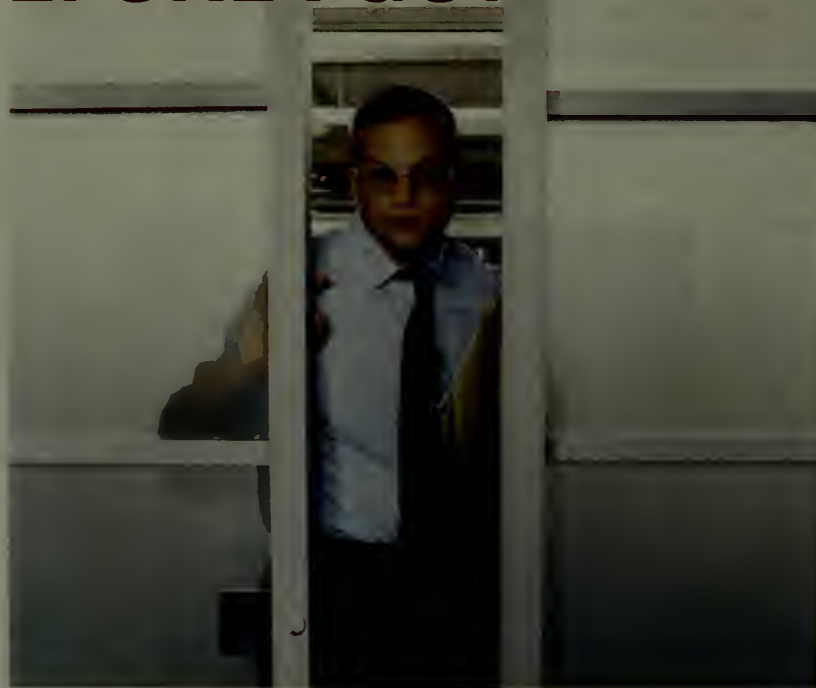
Why would France want to risk alienating its key European ally? One reason could be the recent enlargement of the European Union to 25 members, a vast grouping in which the traditional Franco-German motor can no longer get much traction. In the Iraq crisis, for example, Franco-German opposition to the U.S. was not enough to curb the pro-American enthusiasm of Poland and other East European states. As a Nov. 15 editorial in *Le Monde* put it, "France realized with dread that even allied with Germany, it could find itself overruled in an enlarged Europe." And that, suggests the newspaper that is the mouthpiece of France's elite, is why France is becoming more and more narrowly nationalistic. That doesn't augur well for a powerful new Europe. ■



OLD-STYLE
Sarkozy favors
state-backed
mergers

**France may
be circling
the wagons
in response
to EU
expansion**

**“LET ME GUESS.
JUST ONE MORE THING
BEFORE I GO?”**



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EDITED BY ROSE BRADY

Iran's Nukes: The Crisis Is Far from Over

FOR WEEKS THE RHETORIC mounted as diplomats shuttled between Tehran and Vienna, seeking a solution to the impasse over Iran's nuclear program. The U.S. threatened U.N. sanctions if Iran didn't halt uranium enrichment—a process that can lead to nuclear weapons. Israel hinted it might strike Iran militarily. Vowing

to retaliate if attacked, Iran insisted on its right to “peaceful nuclear technology” as a signatory of the nuclear nonproliferation treaty.

Now there's an apparent breakthrough. On Nov. 14, Iranian and European negotiators agreed that in exchange for European benefits, Iran will suspend all activities that make it possible to build a nuclear bomb. That makes it unlikely that Washington will press the International Atomic Energy Agency (IAEA) to effectively censure Tehran at its Nov. 25 meeting. Hard-liners such as Under Secretary of State John R. Bolton have been demanding that the IAEA refer Iran to the U.N. Security Council for sanctions. He won't get international backing now.

Chain Reaction

IS THE CRISIS over? Hardly. U.S. officials and skeptical Iran watchers fear that Tehran is trying to buy time while continuing its nuclear program—clandestinely if necessary. Iran maintains it is pursuing nuclear technology only for energy purposes.

But some experts believe that as early as next year, Iran will have acquired enough knowhow to make weapons. That could spark a regional arms race, perhaps involving Saudi Arabia, Egypt, or Syria. “There is a high probability there would be a nuclear chain reaction that would ripple through the region,” says arms-control expert Joseph Cirincione at the Carnegie Endowment for International Peace.

The next round of talks between the Eu-

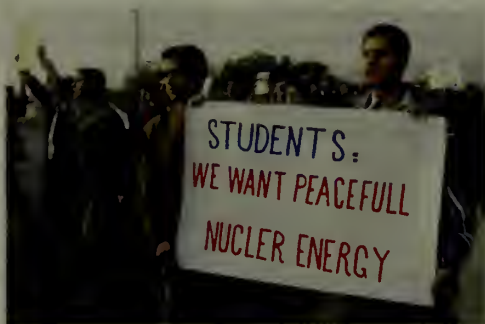
ropeans and Iranians will be crucial to heading off that outcome. The two sides are supposed to meet in December to work out long-term plans for regulating Iran's nuclear program. Washington, which has no diplomatic relations with Tehran, won't take part. But U.S. officials and experts are calling for a deal that lays out penalties if Iran fails to comply. There should be “a policy of carrots and sticks to give Iranians a positive path toward economic integration or incremental punishments if they pursue nuclear weapons,” says Kenneth M. Pollack, a Brookings Institution analyst and author of *The Persian Puzzle: The Conflict Between Iran and America*. An Administration source says the U.S. wants the

IAEA to conduct “anytime, anywhere inspections” in Iran.

The Europeans may seek out just such a deal, partly because they were angry when Iran reneged on an earlier agreement. But if diplomacy fails, there will be few op-

tions left to keep Iran out of the nuclear club if it wants to join. The U.S. may have a hard time winning a sanctions vote in the U.N. China, which imports oil from Iran, has indicated that it would oppose sanctions. Military action, which has been discussed by top U.S. officials, might not work: Iran is believed to have 100 nuclear facilities, some underground. So in the end the world may have to learn to live with a nuclear Iran—and the regional proliferation that could ensue. That's a sober prospect for the Bush Administration. ■

By Stan Crock in Washington, with Babak Pirouz in Tehran and Neal Sandler in Jerusalem



TEHRAN PROTEST Is Iran simply trying to buy time?

GLOBAL WRAPUP

INDIA'S PM REACHES OUT TO KASHMIR

INDIAN PRIME MINISTER **Manmohan Singh** made an important peace overture on Nov. 27 in Kashmir, the violence-torn territory claimed by both Bombay and Islamabad. On his first trip to Kashmir since he became Prime Minister in May, Singh announced a \$5.3 billion, multiyear package of development aid and offered unconditional talks with separatist rebels. Singh's two-day trip was preceded by the withdrawal of some 1,000 soldiers from the state, a confidence-building measure to soothe frayed relations with Pakistan.

ANOTHER MOVE BY WILBUR ROSS IN JAPAN

TURNAROUND ARTIST **Wilbur Ross** is making quite a name for himself in Japan. After doubling his money by selling off a restructured, mid-tier Osaka lender in 2001, Ross has asked Industrial Revitalization Corp. of Japan for a controlling 52% stake in **Mitsui Mining Ltd.**, a troubled importer of specialized coal, Japanese media reports say. Ross is working on behalf of steelmaker **International Steel Group**, where he serves as chairman. ISG will merge early next year with Netherlands-based Ispat International and LNM Holdings to become **Mittal Steel**. At current stock prices, the offer would cost Mittal about \$291 million for a majority position in Mitsui Mining, which the Japanese government is bailing out. Ross, as well as Mitsui and Industrial Revitalization Corp. officials, declined to comment. But if the deal goes through it would mark the first such sale brokered by the IRC to a foreign bidder, and could trigger more mergers.

Out of the Office, Into the Ring

White-collar boxing is exploding—and that's good news for a sport on the ropes

THE MARRIOTT GROSVENOR Square ballroom was packed and ready for a fight on Nov. 10. An audience of well-heeled, dapper captains of the London hedge-fund scene was on hand to watch eight boxing matches, and they weren't disappointed with the sweat and blood. In the main event, a crafty, lanky veteran, John E. Oden—the "Pecos Kid"—with legendary trainer Emanuel Steward in his corner, faced a younger opponent, Gray Smith. Steward noticed that Smith, an aggressive puncher, over-swung with his right, and told Oden to counter. Oden landed a couple of well-placed rights to the face that knocked Smith to the apron both times.

But Oden, who'll only admit to being "on the dark side of 50," isn't quitting his day job. Despite his boxing prowess, in real life he's a principal in money management sales at Bernstein Investment Research & Management in New York. And his foe, Smith, is 38 and a partner at London law firm Maples & Calder. Recalling the sport's aristocratic traditions—boxing's rules were laid down by British gentry—Oden and Smith are but two of a booming number of professional men and women practicing the sweet science.

The ranks of white-collar pugs have

swelled so much that at the storied Gleason's Gym—a decidedly blue-collar boxing redoubt in Brooklyn, N.Y.—they now account for 65% of the membership. That's up from just 10% in the early 1990s. And in London, the Real Fight Club has signed up more than 2,600 City professionals at local gyms in the past four years. At the Wild Card Boxing Club in Hollywood, 70% of the members are white-collar boxers. "They pay the rent," says Freddie Roach, who runs the club.

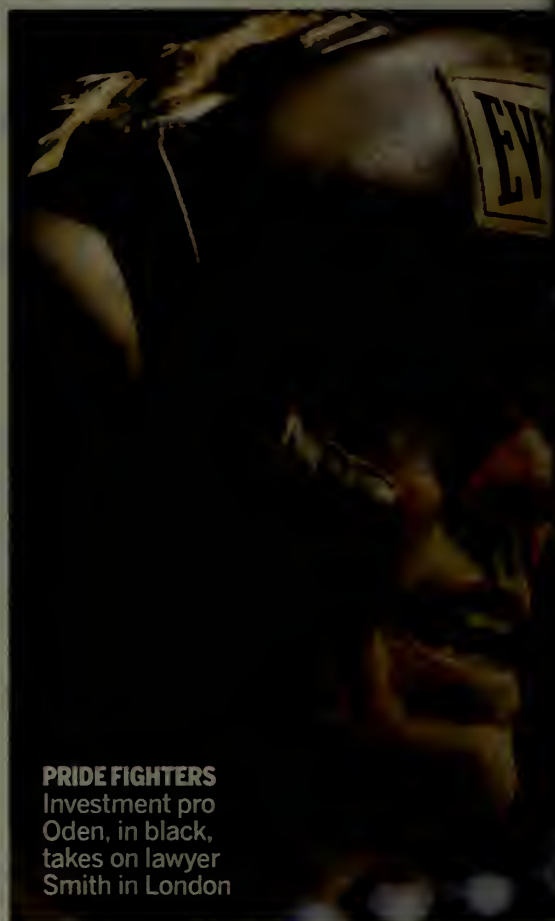
In fact, without the influx of hobbyists, many of the old-style boxing gyms would be down for the count. As fans and local bouts have dwindled and boxing has become a tougher way to make a buck, gym memberships have declined as well, so folks such as Oden and Smith are filling the gap. "White-collar boxers have been the salvation of Gleason's Gym," says owner Bruce Silverglade.

STICK AND MOVE

GOLD TRADERS and derivatives whizzes take up the sport for varied reasons, but for most the draw lies in the unparalleled physical conditioning routine. Many of Silverglade's clients were referred to Gleason's from health clubs such as Bally's after they began a boxing-inspired

cardio workout. The difference: At a boxing gym, a real trainer will not only whip you into shape but show you how to stick and move like a pro.

Boxing gyms generally charge a monthly membership fee that ranges from \$40 to \$70, depending on the city and the size of the gym. That gets you in the door and gives you access to weights, punching bags, rings, and other training equipment. But the real deal begins with a personal trainer. Most gyms have trainers on staff, some of whom work with world-class fighters. They take on new charges for \$25 an hour and up. Steward, who has trained 31 champions including Lennox Lewis and Oscar de la Hoya and runs Kronk Gym in Detroit, doesn't mind working with amateurs like Oden: "The difference between them and the Lewises and the de la Hoyas is they just love the



PRIDE FIGHTERS
Investment pro Oden, in black, takes on lawyer Smith in London

Where to Study the Sweet Science

Boxing gyms are increasingly turning to white-collar fighters to sustain their business. Here are a few:

GLEASON'S GYM Brooklyn, N.Y.

For \$70 a month plus trainers' fees, you can have the same gym access and fitness regimens as the many licensed amateurs and pros who frequent the place

THE REAL FIGHT CLUB London

Founded by a promoter, this club links up City professionals with local gyms for training and makes monthly matches. Fees are \$185 to join, plus gym fees

WILD CARD BOXING CLUB Hollywood

Actors such as Mel Gibson frequent this Hollywood gym, where white-collar fighters make up 70% of the membership. Monthly fees are \$50 and trainers are extra



superior puncher from getting in too many good licks. "I've gotten hurt worse playing soccer," says Bob Marsiglia, a vice-president at Smith Barney in Red Bank, N.J., who took up boxing at a local gym several years ago at age 43.

Given the locker-room, alpha-male atmosphere of the trading floor, it's no surprise that finance-industry types are drawn to boxing. "Most of these hedge-fund guys think they're masters of the universe," says John W. Allen, chairman and chief executive of New York-based Greater China Corp., who attended Oden vs. Smith in London. That's not to mention the cachet that boxing gives you at work and with clients.

Still, such a visceral undertaking—often at a relatively late stage in life—seems to make the white-collar boxer more contemplative, rather than boorish. "It's getting back to your basic instincts as a human being," says Marsiglia. "It's an opportunity to really explore the other side of yourself."

Middle-aged males aren't the only ones climbing into the ring. Women make up a sizable slice of the new fight crowd. Northrup started boxing with his wife, Angela. ("She wins," he says.) Even senior citizens box. Take Raymond J. Rice, who at 78 is training for a bout at Gleason's in January. Rice showed talent for boxing as a 17-year-old in the Navy in World War II. But he laid

off the sport for 50 years, only picking it up as part of a cancer rehab program. "I think I'm going to end it this year," says Rice, who heads an architectural engineering company in Manhasset, N.Y. "Certainly before I'm 80."

Whether drawn to boxing by machismo, a fitness jones, or simple competitive drive, white-collar boxers may help the sport survive. Steward, who has a Kronk Gym outpost in Belfast, Northern Ireland, is considering opening a branch in Los Angeles, since interest is so high, and Oden has helped set up a boxing academy at Intermediate School 174 in the Bronx. "People don't realize what a great form of exercise it is," he enthuses. On that card, at least, it sure outpoints golf. ■

—By Brian Hindo in Brooklyn, N.Y.,
with Laura Cohn in London

Boxing can satisfy some basic urges, but the main draw is the conditioning

boxing—it's not because of the money."

White-collar fighters even get the chance to ply their new trade in the ring. Many gyms offer monthly fight nights where similarly skilled novices can spar in a setting not unlike a licensed amateur bout. In London, the fights are often tied in with black-tie charity events, as was the case with Oden's contest, which was a benefit for Operation Smile, a group that repairs childhood facial deformities. There are no winners—it would be bad for business to score the bouts, says Silverglade.

Training for a fight is a grueling task. To prepare for his London bout, Oden for two months woke every other day at 5 a.m. for a 3½-mile run. Then, after work, he would head to the New York Athletic Club to lift weights and spar, getting ring time as often as three nights a week as the fight drew near. On Saturday mornings he would get in more sparring practice with his friend, retired heavyweight title contender Gerry Cooney. All the while, he abstained from alcohol.

But novices may need up to a full year of out-of-the-ring training before lac-

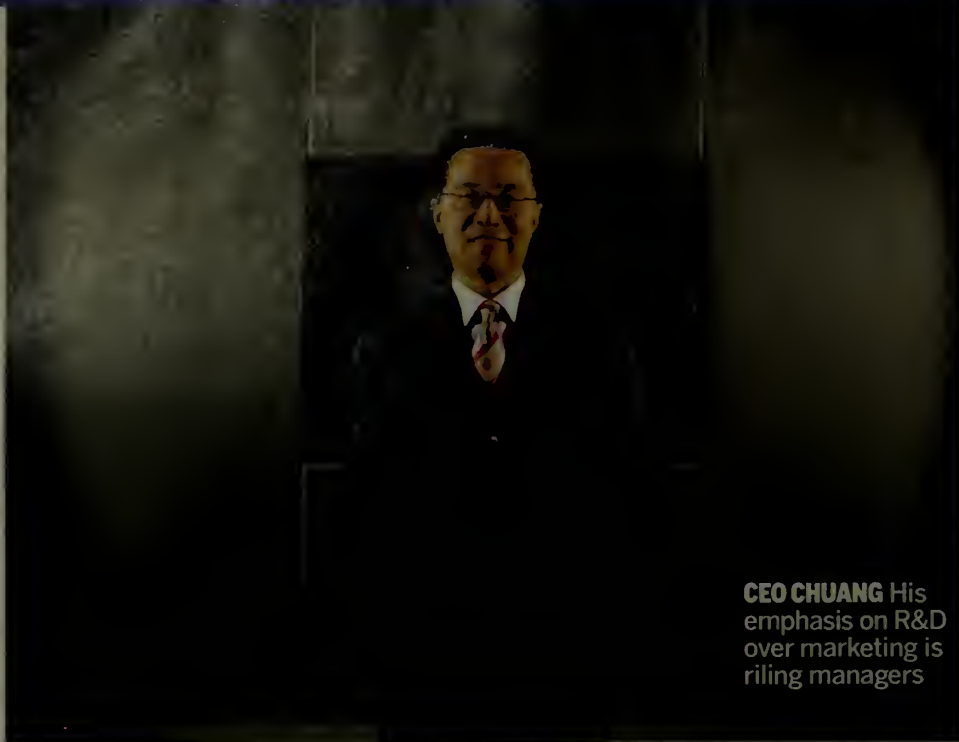
ing up the gloves to spar. It can be an unsettling experience. Jason Northrup, a 34-year-old programmer on the trading floor at Nomura Securities International Inc. in New York, wasn't sure how to behave his first time in the ring. "Should I hit him?" he recalls thinking. And Oden, who has competed in more than 20 bouts in the 13 years he has been boxing, admits it's a disconcerting sight to first see another man charging at you with the goal of punching you square in the nose. "It was frightening," he says. "We had to stop because I couldn't get my breath." It took another month before he got back in the ring.

"MASTERS OF THE UNIVERSE"

OF COURSE, WHITE-COLLAR boxers have to get used to the ineluctable fact that even the best fighters take their share of punches. The boxing gloves soften the blow somewhat, and headgear prevents cuts to the face. But punches still hurt. However, Silverglade says that since 1990, when white-collar boxing started at Gleason's, he hasn't had a serious injury save a couple of broken noses. And at all white-collar bouts, referees are instructed to step in quicker than usual to prevent a

KRONK GYM

by trainer Emanuel Steward, who has trained Sugar Ray Leonard and Lennox Lewis, it costs about \$100 to join; outposts in New York, New Jersey, and soon, L.A.



CEO CHUANG His emphasis on R&D over marketing is riling managers

BEA: A Little Down In the Valley

Not long ago the software maker seemed unstoppable. Now rivals are gaining ground

WHEN ALFRED S. Chuang took over as chief executive of software maker BEA Systems Inc. three years ago, he inherited one of the great Silicon Valley success stories of the 1990s. Started in 1995 by Chuang and two other former Sun Microsystems Inc. executives, BEA had rocketed to nearly \$1 billion in annual revenues by 2001. It dominated the fast-growing market for software that serves as a foundation for Web sites and complex run-the-business applications, with a 34% share. And it appeared ready to take a seat alongside the software industry's giants.

Then BEA stalled. Fierce price competition from rivals coupled with sluggish overall demand led to the stagnating revenues of the past three fiscal years. IBM now has 41.3% market share of the \$3.5

billion market for application servers, compared to 27.5% for BEA, according to market researcher Gartner Inc. BEA's situation is hardly desperate—it has \$1.6 billion in the bank and a base of more than 16,000 customers. But if Chuang can't find a way to get his revenues growing strongly again, his company could suffer the fate of other software pioneers such as Novell Inc. and Sybase Inc.—one-time leaders that were outmaneuvered by more effective competitors. Like them, BEA is in danger of fading in importance and becoming an also-ran rather than fulfilling what once looked like its destiny as a true industry powerhouse.

Can Chuang get BEA going again? The odds are stacked against him. That's because his own leadership is partly to blame for the severity of the company's problems. He has been unwilling to make BEA's prices more competitive with those of its top rivals—IBM and Oracle Corp.,

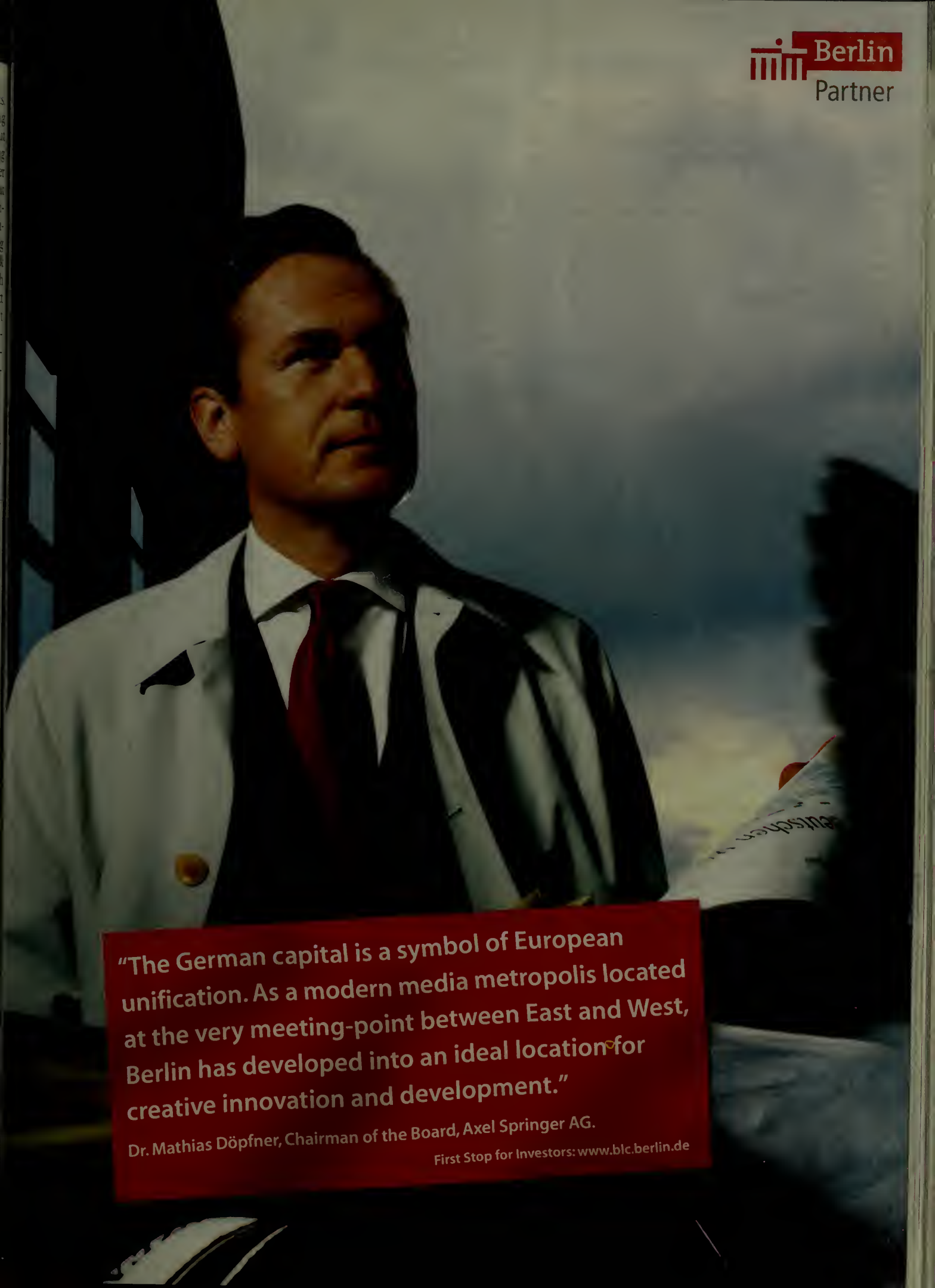
according to analysts and former execs. And while he has begun diversifying BEA's product portfolio, he hasn't put more aggressive sales and marketing programs in place to build those newer businesses rapidly. At the same time, at least six of BEA's top execs have abandoned ship in the past six months, including the chief technology and marketing officers. Two interviewed by *BusinessWeek* said they had become frustrated with Chuang's leadership. Former CTO Scott Dietzen would not reveal why he left but he acknowledged the company's predicament: "BEA has the opportunity to be successful and resume its growth, but it's going to be a challenging road."

DAMN THE TORPEDOES

RATHER THAN REASSESSING his strategies in the face of widespread evidence that they're not working, Chuang is determined to stay the course. He takes great comfort in the fact that BEA has weathered the tech downturn relatively well compared with some of the 1990s' other software upstarts, such as Siebel Systems Inc. He believes that his aggressive investments in research and development—\$140 million for the fiscal year ended in January, up 87% from 2001—will eventually pull the company out of its slump. "In the end, we are not a sales and marketing company," says Chuang. "We differentiate ourselves in the marketplace by being a very, very innovative company."

But that focus alone has never proved successful in creating large and powerful software companies. Consider Oracle, SAP, and Microsoft. They focus on operational expertise and selling—in addition to technology. Indeed, it is typically at the \$1 billion revenue mark that tech companies either develop a balanced approach to doing business or start to struggle. Often that transition includes a change of management philosophy or a change at the top. "It's the point where you go from being just a technology company to a sales and execution company," says analyst Joanne Correia of Gartner, who thinks Chuang needs help. "Alfred is a strong technologist, but they really need a strong businessperson over there." Chuang insists that he's up to the job. Members of BEA's board of directors declined to comment.

In spite of the tumult, Chuang has been able to hold on to many talented engineers. During the downturn, the company only had one round of layoffs—of 300 people. In fact, Chuang has nearly doubled employees devoted to R&D, to

A portrait of Dr. Mathias Döpfner, Chairman of the Board of Axel Springer AG. He is a middle-aged man with dark hair, wearing a light-colored suit jacket, a dark vest, a white shirt, and a red tie. He is looking upwards and to the right with a thoughtful expression. The background is a blurred cityscape with a cloudy sky. A red banner is overlaid at the bottom of the image.

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about 700, while sales staffing has stayed about the same.

The problem is, those investments in technology talent haven't yet shown up in strong top-line growth. In the fiscal quarter that ended Oct. 29, software-license sales slipped by 10.4% to \$114.9 million, even as total sales, which include maintenance fees, grew 4.8% to \$264 million. Analysts expect more trouble in the current fiscal quarter, which ends in January. Software sales are expected to be \$130 million, down 9% from a year ago, says Jason D. Brueschke of Pacific Growth Equities LLC. He forecasts overall sales of \$283 million, up 2% from a year ago, with net income of \$39.8 million, down 7% from a year ago. BEA's stock is trading around \$8.75 per share, almost 40% below its 52-week high and a long way from the \$90 per share of its glory days in late 2000.

INTROVERT AT THE HELM

CHUANG, 43, IS PROBABLY the last guy you would expect to be running a high-profile software company. A self-described introvert, he said in a 2002 interview that he became interested in computers while a college student at the University of San Francisco because "you stare at a glass tube, and you don't talk to anyone." The son of a wealthy Hong Kong businessman, he was so concerned about dealing with the public that he took stand-up comedy classes to help him conquer his shyness. In recent years he has become more confident, even a little flashy. He typically dresses in tailored suits and owns a collection of Ferraris.

He has made a few bold moves at BEA, first as a top exec and later as chief executive. It was Chuang's idea to spend \$192 million to buy a smaller company called WebLogic in 1998. It seemed like a crazy

amount of money for an upstart with 94 employees, but WebLogic's application server turned out to be the key to BEA's rapid rise. Chuang also has tried to improve BEA's effectiveness with customers. In August, he combined sales, marketing, and services—and assigned Tom Ashburn, who had earlier run services for Hewlett-Packard Co., to head up the combined departments. Also, after hearing complaints from customers including Wells Fargo & Co. about slow response to solving problems, he redeployed some of BEA's engineers to work directly with customers.

What Chuang has been unwilling to do for customers is significantly reduce BEA's prices. BEA's typical starting price for its application-server software is \$17,000, about \$2,000 more than a comparable product from IBM. Even bigger is the price difference to keep the software humming. IBM customers usually pay \$6,000 for five years of maintenance and support, while BEA's can spend three times as much. BEA argues that IBM's real costs to customers are hidden in consulting fees.

Chuang says he doesn't need to reduce prices because he's not fighting a price war with competitors. But analysts say he's just plain wrong. "I don't know how you could say there's no pricing pressure," says analyst Correia. Indeed, IBM, Oracle, or Sun can sell their competing software at a discount to BEA's list price because they have other products such as databases or consulting services to make up the difference. E-tailer 1-800-Flowers.com Inc. recently

moved from BEA to IBM in part because of price, says Enzo J. Micali, the company's chief technology officer.

Chuang's refusal to lower prices led to several defections from his executive team. Two former executives, who spoke on the condition that their names not be used, said that starting a year ago and continuing through this summer, at least three of Chuang's managers urged him to drop prices. The former executives also advised Chuang to spend some of the

company's cash to acquire companies with promising new technologies and make BEA even less dependent on the slow-growing application-server business. Newer pieces of the company's portfolio, including Web portal and application integration products, now account for 46% of revenues, up from 30% three years ago. But Chuang said no to any major acquisitions. His

reasoning: Rather than buying new products, he says he wants to develop them internally. Before the end of the year, he expects to release software tailored for telecommunication companies offering voice service over the Internet.

But innovation is no longer a trump card for BEA. While analysts say it still has the best products, the gap has narrowed to a sliver. And the history of tech has shown that a company with slightly better products almost never beats out a rival with a much cheaper offering. With so many aggressive competitors closing in, time is running out for Chuang to come to grips with that brutal reality. ■

—By Jim Kerstetter in San Jose, Calif.,
with Jay Greene in Seattle

Can BEA Turn Itself Around?

Onetime highflier BEA Systems has been stuck at about \$1 billion in revenues for three years. Here's what the software maker must do to grow again.

CHALLENGE

ENTER NEW MARKETS BEA must expand sales beyond its core slow-growing businesses of application servers and developer tools.

GET ACQUISITIVE With more than \$1.6 billion in cash and short-term investments, BEA can acquire smaller companies with key technologies, particularly software that tests computer networks.

CUT PRICES BEA has terrific technology, but it's losing ground to IBM and open-source competitors such as JBoss that undercut its prices.

PROGNOSIS

GOOD The company is delivering software for Internet telephone networks and financial processing systems—and plans more new products.

POOR CEO Alfred Chuang has shown little inclination to make acquisitions.

POOR Chuang has resisted trimming prices. He centralized sales, services, and marketing—but that hasn't been enough.

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COMMENTARY

BY SPENCER E. ANTE

Online Wine: Pull Out the Stopper

The Supreme Court should strike down state laws that restrict sales on the Web

FOR YEARS, CALIFORNIA winemaker Terry Speizer put up with the shackles on his business. He was resigned to being unable to sell his pinot noirs and syrahs to nearly half the country because of restrictive state laws. But in 2000, he hit his breaking point. Michigan wine critics Ray and Eleanor Heald asked to review a pinot from his Domaine Alfred winery—and he

couldn't ship them one measly bottle. Michigan is one of 11 states that bar out-of-state wineries from sending bottles directly to consumers, while allowing in-state wineries to do the same thing. Soon after, Speizer and the Healds filed a lawsuit challenging Michigan's law. "It makes no sense," says the winemaker.

Now, Speizer is getting his day in the nation's highest court. On Dec. 7, the U.S. Supreme Court is scheduled to begin hearing oral arguments in his lawsuit and a similar suit from New York. These cases pit alcohol wholesalers and dozens of state attorneys general against wineries and online wine stores. The plaintiffs say the Constitution gives the federal government—not the states—the right to regulate interstate trade. Defendants assert that the 21st Amendment, which ended Prohibition in 1933, gives states the near-absolute right to regulate the sale of alcohol. This conflict between state and federal rights has existed for decades, but the advent of the Internet and the explosion of new wineries has put the issue front and center.

While there's merit on both sides, the Supreme Court should strike down the restrictive state laws. For starters, the legal arguments of Michigan and the 10 other restrictive states are questionable. In 1933, few wineries anywhere were shipping to customers. But since then, local wine businesses have proliferated, and these 11 states have created laws favoring in-state wineries. That's exactly the kind of discrimination the Constitution prohibits. What's more, lower courts have noted there are nondiscriminatory ways to protect states' interests.

In addition, there's little question that lifting state bans would benefit consumers and small wineries. That's true in those 11 states, and in 13 other states that ban all direct shipping. A 2003 Federal Trade Commission study found that direct shipping and online wine sales would "significantly enhance consumer welfare." One big reason



is price. The FTC found that online wine sellers offer savings of 8% to 21% over brick-and-mortar stores. Another benefit is choice. There are 3,700 wineries in the U.S., but the lion's share can't reach many areas because traditional wholesalers can't afford to work with most small vineyards. Only 13.4% of California's 800 wineries had distribution in all 50 states last year, says the Wine Institute, an advocacy group for the state's wineries.

No question, there are reasons to be wary of direct shipping. Some state attorneys general and liquor wholesalers argue that opening a state's borders makes it easier for merchants to avoid sales taxes and for minors to drink. Indeed, states have struggled to collect taxes on out-of-state purchases, as online sales of books and autos have shown. Still, the wine industry has voluntarily agreed to remit taxes. And the states don't have to rely on blind trust. They could follow the lead of the 26 states that allow direct shipping by requiring out-of-state wineries to obtain licenses and report sales. The FTC report found that these "states report few, if any, problems with tax collection."

Underage drinking may be even less of an issue. A 2004 National Academy of Sciences study found that parties, friends, and strangers are the most frequent way kids obtain booze. Still, to deter underage drinking, the states that allow direct shipping require an adult signature upon delivery. That's not a perfect solution. But with vigilant enforcement, it's a reasonable option.

Let's hope the Supreme Court sees the wisdom of direct shipping. Then, more folks could enjoy vintages from Domaine Alfred and hundreds of other wineries—and pay reasonable prices. ■

THE STAT

24

Number of states that ban out-of-state wineries from shipping directly to consumers. Among them are Michigan and New York.

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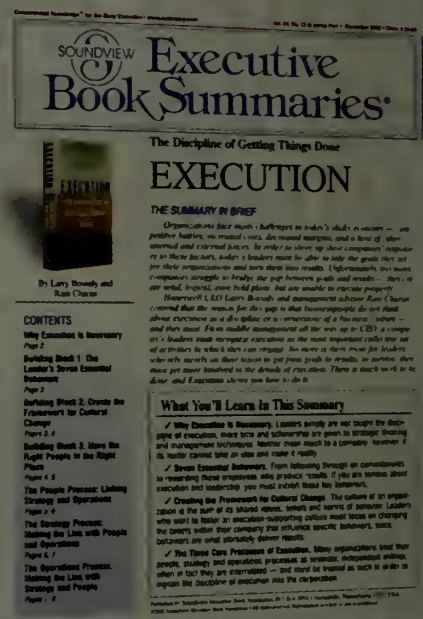
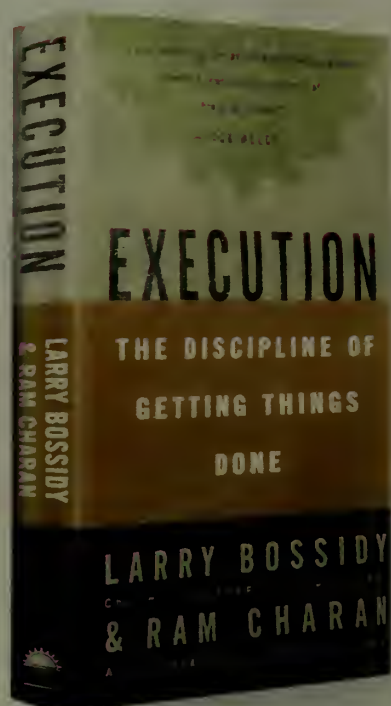
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COMMENTARY

BY AARON BERNSTEIN

Minimum Wage: The States Get It

Since Congress won't raise hourly pay, local lawmakers are taking the lead

FLORIDA GOVERNOR Jeb Bush helped to deliver 52% of his state's votes for his brother on Nov. 2, but that didn't stop fully 72% of voters there from backing a GOP-unfriendly ballot initiative: raising the minimum wage. The popular measure set a state wage floor of \$6.15 an hour, a buck higher than the federal level, which hasn't been lifted since 1997. It also pegs

the state's new minimum to inflation, so that the lowest-paid workers will get automatic increases each year to keep their purchasing power in line with consumer price hikes.

The initiative, to which Governor Bush offered only tepid opposition, makes Florida the 13th state to lose patience with the federal government and set its own higher minimum. It's also the third, following Washington and Oregon, to index its minimum wage to inflation. Both of these ideas are long overdue and should be emulated by Congress and other states.

True, if wage floors are set too high, employers will create fewer jobs, and the lowest-skilled Americans will lose more than they gain. This is the argument some business groups made in Florida and continue to make about the federal minimum, says Stephen R. Birtman, Florida state director of the National Federation of Independent Business (NFIB).

But new research over the past decade shows that modest hikes to keep the low-paid abreast of inflation will cost few if any jobs. The point has been widely embraced since 1995 studies by University of California at Berkeley economist David Card and Princeton University economist Alan B. Krueger found no employment losses among New Jersey fast food restaurants hit with minimum-wage hikes. Given wide variations in costs around the country, the federal minimum should serve as a floor, which would allow high-cost states such as California or Alaska to set

their own minimums higher if they wish. "Indexing doesn't improve conditions for low-wage workers, it just keeps them from deteriorating further as prices rise," says Robert Pollin, an economics professor at the University of Massachusetts at Amherst who led a study of the Florida initiative for its advocates.

Certainly, there are few credible reasons left to oppose an increase of the federal \$5.15 an hour. That sum gives a full-time worker barely more than \$10,000 a year, despite a family poverty level that has climbed to \$18,600. Indeed, the federal minimum was 40% higher in 1968, or \$8.50 in today's dollars. So lifting it by a dollar or two wouldn't even come close to restoring low-wage workers' purchasing power back to where it was more than 25 years ago.

Employers of low-wage workers—mostly restaurant and hotel chains and small companies represented by groups such as the NFIB—have enough clout in Washington to a block minimum wage hike. But the idea has widespread support. As many as 123 cities have passed "living wage" laws, which set higher minimums for workers employed by city contractors. "Even most people in red states like Florida know that \$10,000 a year is a joke to live on," says Jen Kern, director of the Living Wage Resource Center at ACORN, an antipoverty group that spearheaded the Florida initiative and others.

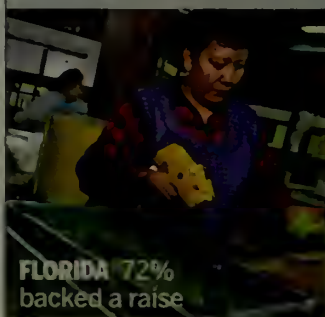
Some critics argue that the Earned Income Tax Credit is a better way to lift up the poor. The reason: The EITC, which gives tax dollars to the lowest-income

workers, targets the poor more directly than the minimum, which also covers people such as affluent teenagers.

There's truth in this view, but the EITC would work even better with a federal minimum pegged to inflation. Welfare reform and the EITC have lured more single mothers into the labor force since the mid-1990s. But in doing so, they expanded the supply of low-skilled workers, holding down low-end wages, points out David Neumark, a senior fellow at the Public Policy Institute of California. An indexed minimum would offset that downward pressure, creating complementary policies that bring up those on the bottom to rise along with the rest of us. ■

Lifting the Wage Floor

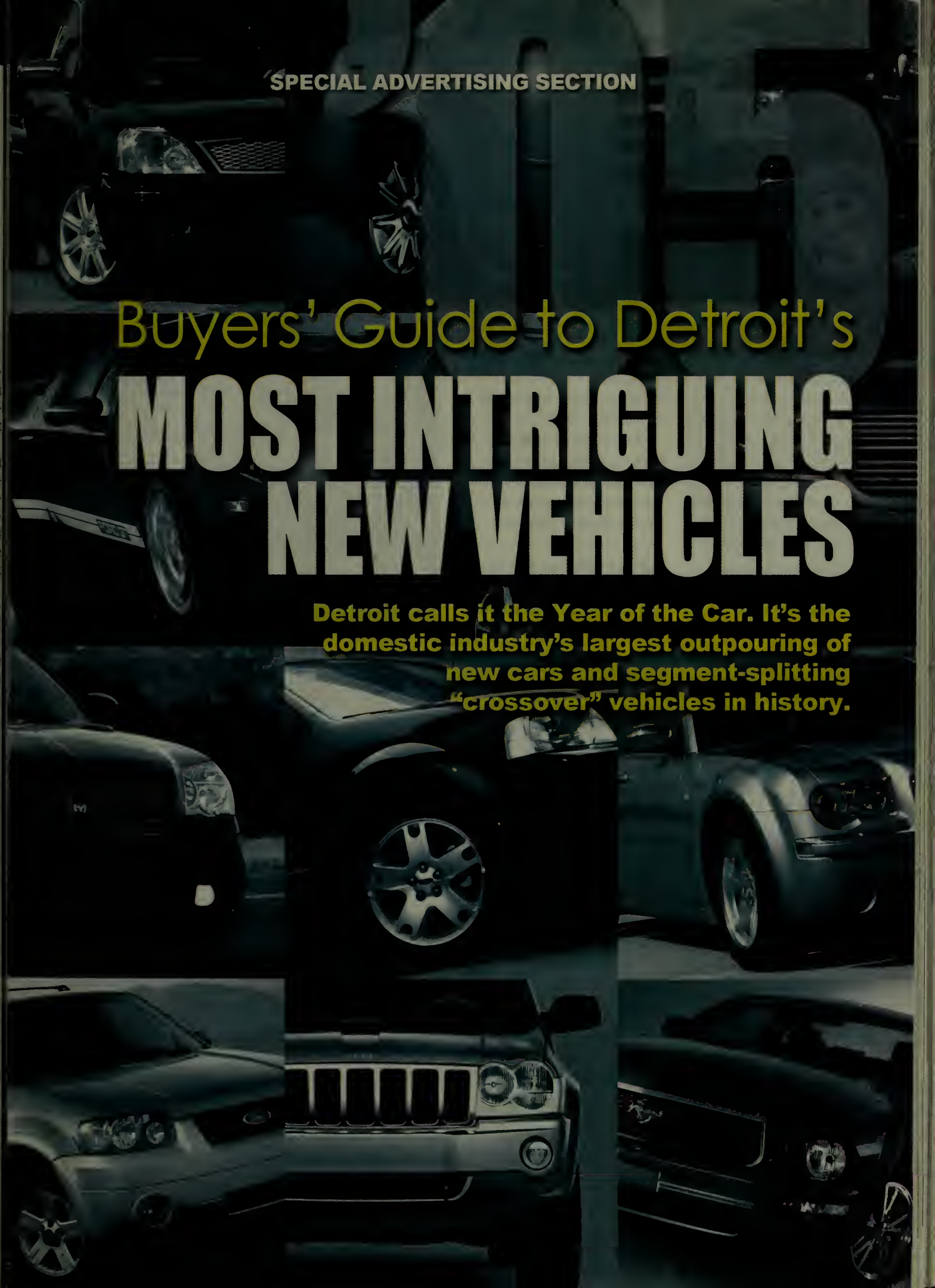
Thirteen states have set minimum wages above the federal \$5.15 an hour. In Florida, Oregon, and Washington, rates are indexed to inflation.



Washington	\$7.16*
Alaska	7.15
Connecticut	7.10
Oregon	7.05
California	6.75
Massachusetts	6.75
Rhode Island	6.75
Vermont	6.75**
Hawaii	6.25
Maine	6.25
Delaware	6.15
Florida	6.15
Illinois	5.50***

*\$7.35 as of Jan. 1
***\$6.50 as of Jan. 1
**\$7.00 as of Jan. 1
Data: Labor Dept.

Data: Labor Dept.



SPECIAL ADVERTISING SECTION

Buyers' Guide to Detroit's **MOST INTRIGUING NEW VEHICLES**

Detroit calls it the Year of the Car. It's the domestic industry's largest outpouring of new cars and segment-splitting "crossover" vehicles in history.



FORD FIVE HUNDRED

A full-size, upscale sedan with refinement, understated looks and loads of room.

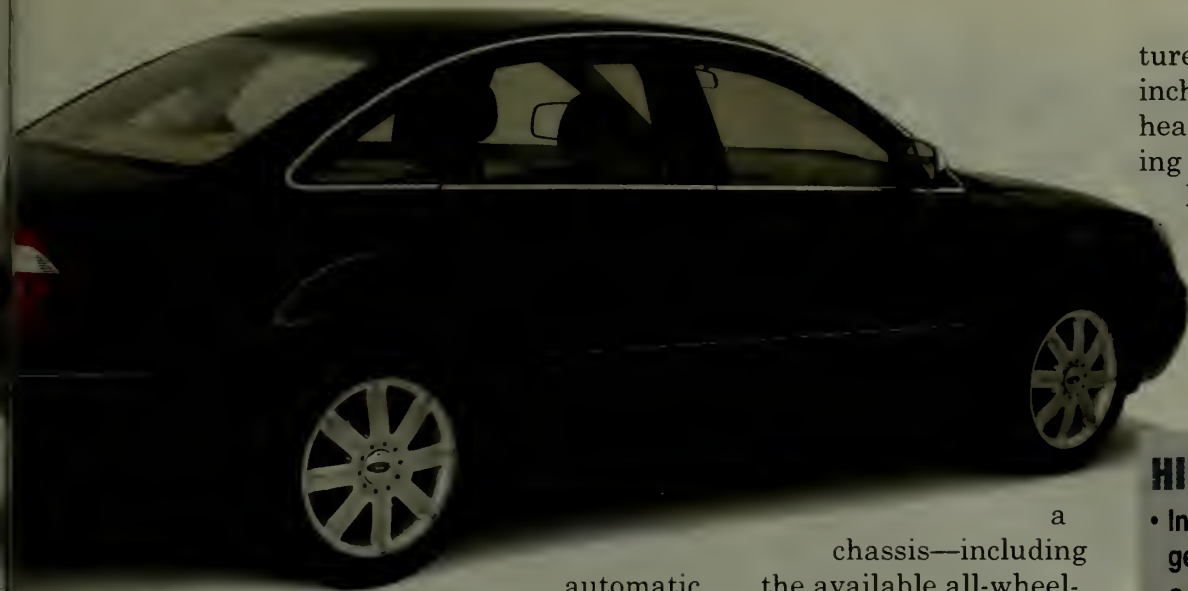
Ford Motor Co.'s new Five Hundred replaces the venerable Ford Taurus with a larger and more sophisticated sedan that features nearly the same interior roominess as a Lincoln Town Car, a huge 21.1 cu. ft. trunk, optional all-wheel drive and a "tall" seating

position akin to what drivers might expect in an SUV.

The Five Hundred targets consumers in their 40s to mid-50s whose children are in high school or beyond.

Refined materials and design give the Five Hundred an upscale look and feel.





tures include 17- or 18-inch wheels, automatic headlamps, power folding outside mirrors, keyless entry keypad, tilt steering wheel, and power/ heated front seats with memory.

HIGHLIGHTS:

- Industry-leading passenger space and trunk room
- Seating 3-4 inches higher than conventional sedans
- Fold-flat rear and front passenger seats
- Volvo-inspired chassis safety features
- Occupant-sensing front airbag system

Its image: refinement rather than flash at a very competitive price (\$23,000-\$28,000).

The front-drive Five Hundred offers plenty of standard or optional technology: six-speed

automatic or continuously variable transmission, a front/rear side curtain airbag system with rollover protection, dual piston front brakes, rear object detection, fully independent suspension, self-leveling shocks, and

a chassis—including the available all-wheel-drive system— derived from running gear used by Ford's Volvo unit.

Powering the Five Hundred is a 203-hp Duratec V-6 engine that delivers about 27 mpg on the highway.

Other notable fea-

BUILT FOR COMFORT.



THE 2005 FIVE HUNDRED

FORD FREESTYLE

Designed for 30-something families that want car-like comfort and SUV-like utility.

Crossover vehicles that merge the ride and handling of a car with the roominess and flexibility of an SUV have created America's hottest vehicle segment.

Freestyle is Ford's new crossover entry. Sharing a platform with the new Five Hundred

sedan, the Freestyle (\$25,600 to \$30,500) aims to bridge the gap between traditional cars and SUVs. Ford says it was developed from the

ground up for Gen X families that want three rows of flexible-configuration seating that can accommodate up to seven adults—or fold down

to create the cargo capacity of a full-size SUV.

Another SUV-like feature: The Freestyle's front seats are about four inches higher than



those in a conventional sedan, so occupants get a better view of the road. Yet the seats are also roughly five inches lower than those in a midsize SUV, so entering and exiting is easier.

Like the Five Hundred sedan, the

front-drive Freestyle is powered by a 203-hp V-6 engine and is available with a six-speed automatic or continuously variable transmission.

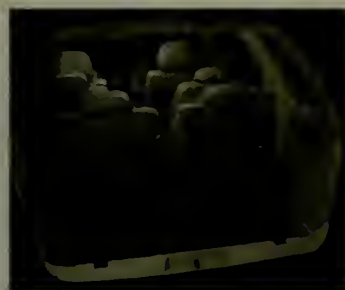
Freestyle comes in three trim levels. An unusual option for a vehicle in this price

HIGHLIGHTS

- Three rows of theater-style seating with best-in-class roominess
- Optional six-disc CD change, MP3 capability and audiophile sound system
- Available side curtain airbag system with rollover protection

range—and one worth considering if sure-footed performance in poor weather is an issue: a Volvo-designed all-wheel-drive system (\$1,700).

The Freestyle offers a plush interior with dozens of seating/cargo configurations.



BUILT FOR POSSIBILITIES.



THE 2005 FREESTYLE

FORD MUSTANG



An all-new design with more room, a longer wheelbase and the look of the original.

The iconic Mustang turned 40 years old this year, and Ford is celebrating with the car's first major over-

haul in more than two decades. The result: a longer and roomier model with a thoroughly modern interpretation of

classic Mustang styling cues to stir the soul of 50ish consumers who grew up with the original version.

Unlike many vehicles, the Mustang (base-priced at \$19,400 to \$25,000) appeals to a very wide range of consumers. About one in four Mustang owners is under 30 years old. Half are midlife baby boomers, and more than one in 10 is at least 60 years old.

The 2005 Mustang offers a new base engine:





a five-speed manual or automatic transmission.

The car's wheelbase, nearly 6 inches longer than before, combines with about 5 inches of additional body length to

center-mounted Mustang emblem, round dash-mounted vents, and chrome-ringed dual instrument cluster.

For now, the 2005 Mustang is available only as a two-door coupe. But open-air lovers needn't worry: The convertible Mustang will be available next spring.

HIGHLIGHTS:

- Classic styling with an all-new platform, more agility, and enhanced safety features
- More power in all models
- Lowest-priced rear-drive sports car on the market
- The rebirth of a 40-year-old American icon

a 4-liter, 210-hp V-6 with overhead cam. The GT model comes with a 4.6-liter V-8 that generates 300 hp, making it the most powerful mainstream Mustang ever.

Both engines are more powerful than the ones they replace, and each can be coupled with

give the new model's profile a more lithe look.

Inside, the new car recalls several design touches that graced the original model. Among them are a three-spoke steering wheel with

Classic touches: three-pane tail lamps and round Mustang emblem.




BUILT FOR POWER.



THE 2005 MUSTANG

FORD ESCAPE HYBRID

The world's cleanest SUV delivers more than 35 mpg in the city.



This little SUV offers the acceleration of a V-6-powered model, but with 75% better fuel economy where it counts most: in city driving.

The Ford Escape Hybrid (about \$27,000) marries a four-cylinder gasoline engine and powerful electric motor that take turns (or work together) to propel the vehicle in the cleanest and most fuel-efficient way possible.

Because it's a hybrid, the system never needs recharging. On the contrary, you can order one with its own 110-volt AC outlet and use the four-wheel-drive Escape Hybrid to power a TV set or other appliance.

FORD GT

550 horsepower and a top speed of 205 mph!

They don't come much racier than this. Inspired by the Ford GT of the 1960s that defeated Ferrari at Le Mans three years run-



This is unprecedented. Never in Ford history have we introduced so many ways to take on the roads of America. Six all-new models. Destined to change the face of not only our showrooms, but the entire automobile industry. See them all at "The Next Generation of Ford Sales Event" at your local Ford Dealer, November 18-21. Visit fordvehicles.com.



FORD F-SERIES SUPER DUTY

More power and a new look for the captain of Ford's F-Series pickup truck line.

If you're serious about your pickups, the Super Duty end of Ford's F-Series truck line deserves a special look in 2005.

That's because Ford has freshened the Super Duty series inside and out—and equipped these heavy-duty trucks

with best-in-class power, torque, towing (up to 17,000 lbs), and payload (up to 6,000 lbs).

Also new for 2005 is TowCommand, the

industry's first factory-installed, electronic trailer brake controller that includes the ability to respond to poor traction conditions that activate the truck's antilock braking system.



BUILT FOR THE ROAD AHEAD.



ning, the mid-engine GT delivers no-compromise supercar performance—zero to 60 mph in about 3.3 seconds, for example—for about \$135,000.

The aluminum-bodied GT is powered by a supercharged 5.4-liter V-8 engine and six-speed manual transmission with output similar to the original GT.



JEEP GRAND CHEROKEE

An all-new exterior, new full-time 4x4 options, and the first-time availability of Chrysler's legendary HEMI engine.

Almost everything is new about the third-generation Jeep Grand Cherokee for 2005 except one thing: its legendary off-road capabilities.

For 2005 Jeep introduces three new full-time four-wheel-drive systems for the Grand Cherokee that enable customers to tailor performance to the amount of offroading they do. All three systems automatically manage power flow to all four wheels, eliminating the need for drivers to shift the transfer case in or out.

Grand Cherokee (about \$32,100) also

comes with a new front and rear suspension, rack and pinion steering, and a tighter turning circle—all of which contribute to better ride and handling.

Under the hood, customers can now order a 330-hp HEMI V-8 engine that offers best-in-class

power combined with electronic cylinder-deactivation for up to 20% better fuel economy.

It's all wrapped in new bodywork for 2005 and an all-new interior with more headroom, added cargo flexibility, and new electronic amenities.



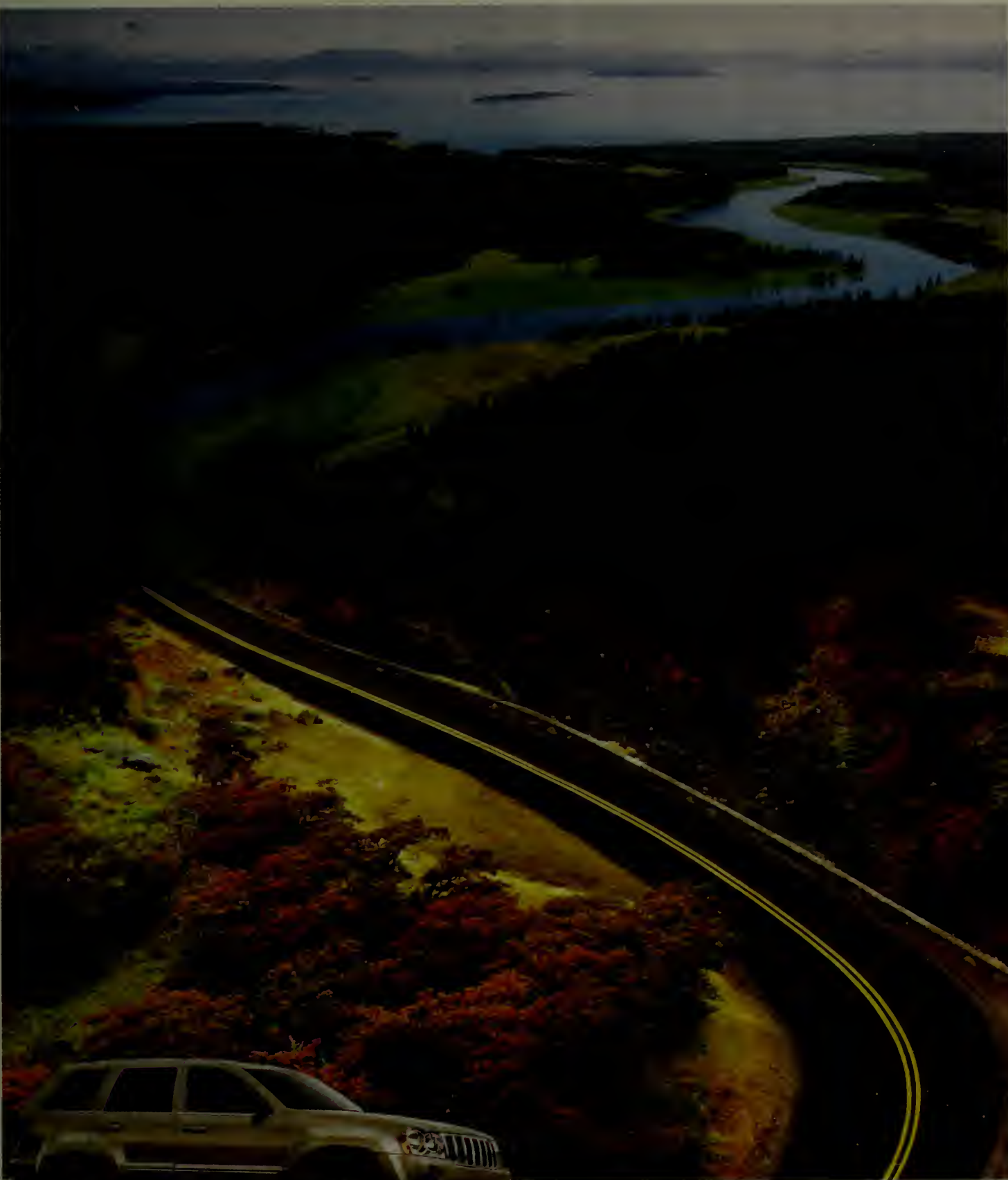
Two-tone interior trim and new finishes give the Grand Cherokee a more sophisticated feel inside.



Folding headrests and retractable cupholders allow the rear seat to fold flat.

HIGHLIGHTS:

- HEMI V-8 engine option
- New, more fuel-efficient five-speed automatic transmission
- Three new full-time four-wheel-drive systems
- New suspension and steering systems with optional electronic stability control



**ALL NEW JEEP® GRAND CHEROKEE.
THE OFF-ROAD LEGEND CONTINUES...ON-ROAD.**

Now you can make the most of every journey, no matter what the terrain. The new Trail Rated® Jeep Grand Cherokee features a 330-hp 5.7L HEMI® V8,* the most powerful engine in its class†; an Electronic Stability Program‡; and Quadra-Drive II,§ our most advanced four-wheel-drive system ever. Visit jeep.com

Jeep

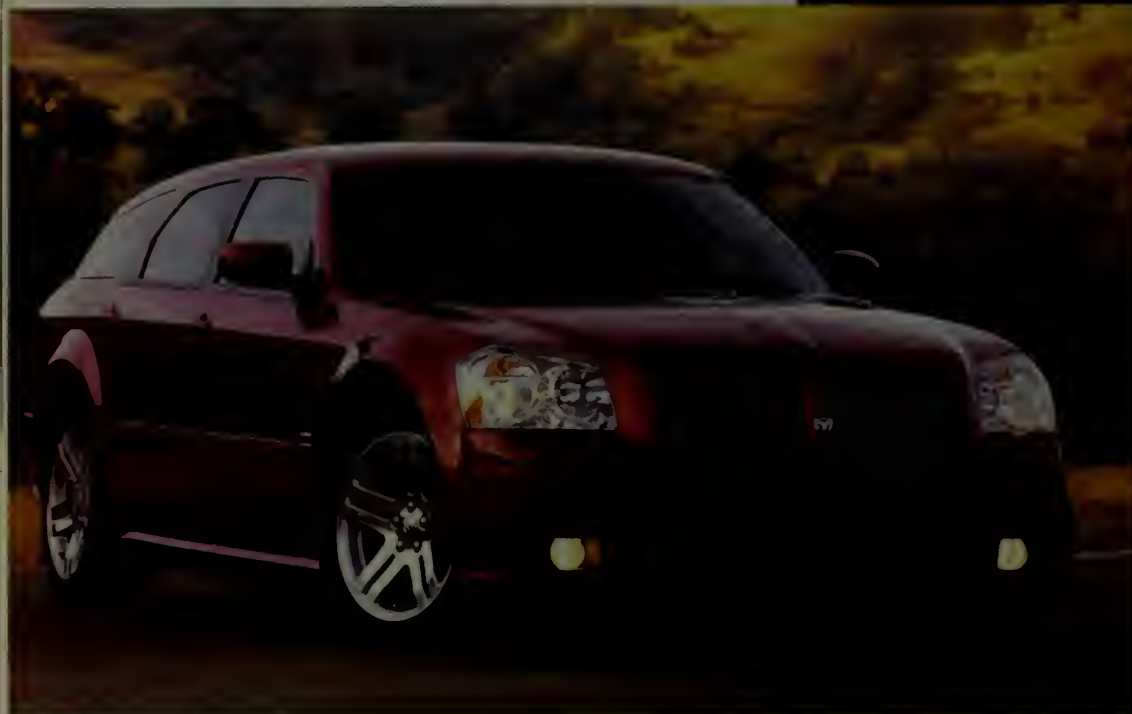


Chrysler Financial

Jeep, Trail Rated, and HEMI are registered trademarks of DaimlerChrysler Corporation. *Only available on Limited 4x4 model. †Based on 2004 Ward's Middle/Sport Utility Segment and published industry information. ‡Available.

DODGE MAGNUM

Part sports sedan. Part SUV. Part hot rod.
It's an all-new vehicle with one of the market's most distinctive profiles.



Magnum has a sporty instrument panel and "taller" seats for a better view of the road.

HIGHLIGHTS:

- 340-hp HEMI V-8 engine with fuel-saving multi-displacement system; gutsy 3.5L V-6 in SXT model
- Available all-wheel drive
- Safety: self-sealing tires, traction control, electronic stability program, 5-star frontal crash test rating from NHTSA

Call it a muscle car with good manners and the flexibility of an SUV. It's not quite a wagon but not quite a car either.

The all-new 2005 Dodge Magnum defies classification. It offers buyers handling and power akin to a German sport sedan, the cargo capacity of a midsize SUV, and macho styling that gives it one of the most distinctive profiles

of any vehicle on the American road today.

Magnum aims at consumers who want to drive something with a youthful, masculine, and aggressive image—but with more utility than, say, a sports car.

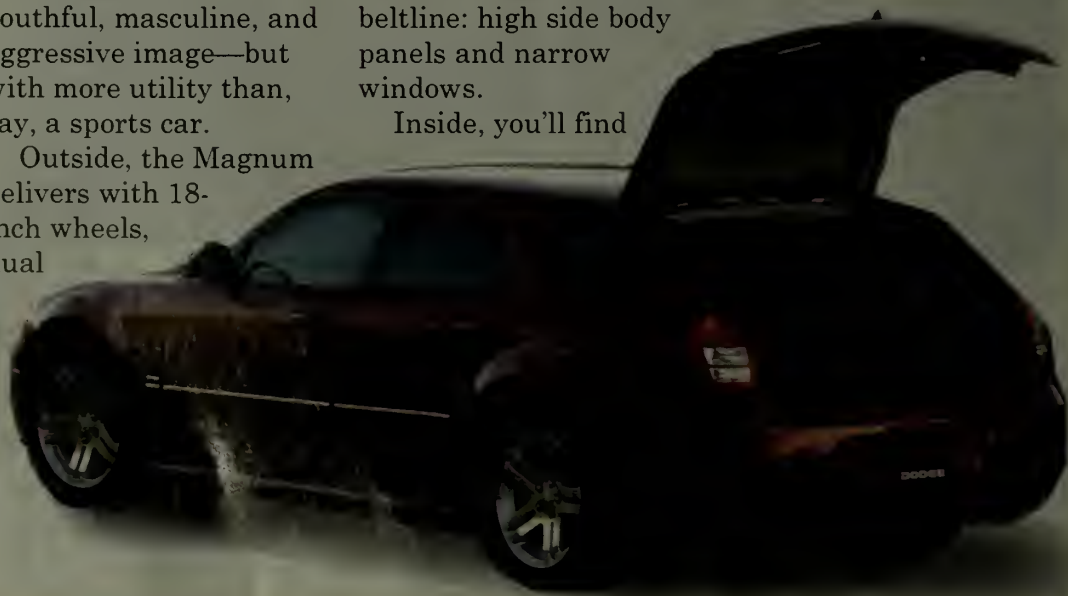
Outside, the Magnum delivers with 18-inch wheels, dual

exhaust pipes, a massive grille, long hood, sloping roofline, minimal ornamentation, and the powerful look of a "tall" beltline: high side body panels and narrow windows.

Inside, you'll find

a sporty instrument panel with trim rings similar to those on the Dodge Viper sports car and a split rear seat that folds flat with hidden storage areas underneath.

Magnum has an unusually easy-access cargo opening, thanks to a rear gate hinged well into the roof.



GRAB LIFE BY THE HORNS



DODGE

INSPIRED
BY U-HAUL

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BY NASCAR®



THE ALL-NEW DODGE MAGNUM RT. OPEN IT UP FROM EITHER END. Put the pedal down and you'll find the power of a 340-horsepower HEMI® V8 engine and the performance of world-class ride and handling. Lift the unique access liftgate, and you'll find more cargo space and comfort than you ever thought possible. Dodge Magnum. Either way you open it, it's perfect for you. Visit www.dodge.com or call 1-800-4ADODGE

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★★★★★
FIVE-STAR

HIGHEST GOVERNMENT
FRONTAL CRASH TEST RATING

Dodge Financial





CHRYSLER 300C

A distinctly American style sedan with European-style handling and impressive HEMI power.



Chrysler's famous 5.7 liter HEMI V-8 engine is standard.

position than conventional cars, understated two-tone interior trim that combines

opulence and sportiness, and silver-faced instrumentation.

For drivers who like driving, the biggest attraction of the 300C has to be the 340-hp HEMI V-8 under the

hood. Optional all-wheel drive help deliver power to the road effectively.

Rack and pinion power steering, electronic stability control, and an all-new suspension system that gives the 300C impressive ride and handling characteristics.

Standard safety features include auto-reverse power windows, rain-sensing wipers, antilock brakes, traction control, and an electronic stability system.

HIGHLIGHTS:

- 340-hp HEMI engine with automatic cylinder deactivation to boost mileage
- Rear- or optional all-wheel drive
- 18-inch aluminum wheels with chrome cladding
- antilock brakes, traction control, and electronic stability system

The Chrysler 300 has been a smash hit from the day it debuted earlier this year. Topping the line is the 300C (about \$33,500) with legendary HEMI power, dual chrome-tipped exhaust pipes, and special badging and interior trim.

Chrysler says the 300 conveys the essence of its brand: power, elegance, and innovation.

The 300C features projector beam headlamps, a higher seating

The Chrysler 300C features tortoise shell trim on steering wheel rim, shifter knob, and inside door pulls.



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Author Bill Hampton, who has written about the auto industry for more than 33 years, publishes AutoBeat Daily, a news digest about activities of the global auto industry.

Graphic design by Andrea Stork: Design.

Chrysler 300 starts at \$23,920* > U.S. government's highest ★★★★★
5-star front impact crash test rating > To learn more about safety features,
take a virtual tour at CHRYSLER.COM/300, or call 1.800.CHRYSLER >

CHRYSLER



INSPIRATION COMES STANDARD

THE TOTALLY NEW
CHRYSLER 300C



Can inspiration lead to something totally unexpected? Yes. Can the performance sedan
be rejuvenated? Yes. And can HEMI® power arrive
with such style for under 34K*? Absolutely.



*As shown: \$33,495. MSRP excludes tax. Includes Premium Care Plan. 7-year or 70,000-mile Powertrain Limited Warranty on Chrysler vehicles. See dealer for a copy of this limited warranty. Transferable to second owner with fee. A deductible applies. Excludes SRT models. For more information about Chrysler Financial, ask your local dealer.

Chrysler Financial

SPECIAL REPORT **PHILANTHROPY** 2004



BUFFETTS
ie's death put
ren into the
ga-giver ranks

THE TOP GIVERS

In our annual rankings, normally generous philanthropists played "supersize me"

BY MICHELLE CONLIN, LAUREN GARD, AND JESSI HEMPEL

WARREN BUFFETT IS FAMOUS FOR TWO THINGS. FIRST, FOR amassing the second-biggest fortune in the U.S. as one of the most talented investors the world has ever known. Second, for an aversion to spending a dime of that \$41 billion on anything but the strictly necessary. That includes declining to provide his kids with fortunes of their own, collecting yachts or racehorses, or giving large chunks of his wealth to worthy causes. Thus it may strike some as the supreme paradox that the man who is one of America's greatest misers in life will probably become one of its greatest philanthropists in death. That reality came into focus in July, when Susie, Buffett's wife and philanthropic muse, died of a stroke at 72. Now, the bulk of Susie's Berkshire Hathaway stake—\$2.5 billion—is pouring into the foundation that she and Warren shared, a tiny Omaha operation that supports reproductive choice and nuclear weapons reduction but that has mostly operated under layers of secrecy. What is known is that Susie's gift vaults Warren to No. 3 on *BusinessWeek's* third annual ranking of the Top 50 U.S. philanthropists, up from No. 26 last year. (For the purposes of the *BW* ranking, married couples are generally treated as a single entity.)

Susie Buffett's bequest was just one in a year defined by astonishingly supersized donations. The slew of record-shattering gifts suggests that at least a sliver of the voluminous gains of the late-'90s stock boom is being funneled back into society—and that today's Carnegie libraries and

Rockefeller yellow-fever vaccines can't be far behind.

The year's other billion-dollar-club members include No. 1 givers Bill and Melinda Gates, the world's largest international donors, who made history this year by giving their estimated \$3 billion Microsoft Corp. dividend to their foundation. It's one of the largest donations in history by a living donor. To put it into perspective, that one gift is three times bigger than the amount that America's richest family, the descendants of Wal-Mart Stores Inc. founder Sam Walton, has given during their entire lifetimes, according to our ranking.

Others on our list contributed mega-gifts in the hundred-million range. No. 2 donors Gordon Moore, co-founder of Intel Corp., and his wife, Betty, pledged \$275 million for ocean research and eradicating hospital error through world-class nurse training (the latter gift stemming from Betty's own negative experiences in medical facilities). List newcomer and medical-device mogul Alfred Mann gave \$200 million for medical research institutes in Israel and at Johns Hopkins. "Money is only worth what you can do with it," says Mann, the 78-year-old son of an immigrant grocer, who still works full time and intends to leave his entire \$1.4 billion estate to charity. "Other than that, it's not worth a damn."

SCHOOL DAYS

THE YEAR OF THE MEGA-GIFT also saw a string of donations to universities that were unprecedented in their size. Liquor import king and Top 50 newcomer Sidney E. Frank, the son of a Connecticut orchard man, slept on sheets sewn from sacks until he got to Brown University. In September, he gave the school \$100 million to fund scholarships for up to 130 kids a year whose families can't afford the \$31,000 annual tuition and the \$8,500 room and board. The gift was inspired by Frank's own need to drop out after his freshman year because he couldn't afford tuition. This was the largest gift in Brown's history and one of the single biggest donations ever toward undergraduate scholarships. Then there's Related Cos. CEO Stephen M. Ross. Though he didn't qualify for the Top 50, he pledged \$100 million to the now-named University of Michigan Ross School of Business. Never has the 187-year-old university received a gift so huge—nor has any other U.S. business school.

Rather than hoard their GDP-sized fortunes, many in the Top 50 became more extravagant in their charity this year, urged on by a growing belief that the value of solving problems today is greater than bequeathing the money when they die. And by accelerating their giving and doling out large sums, they have a better



WHY WAIT? Michael and Susan Dell are giving it away while they're still young

chance of effecting change. "The realization is that it takes that much money to move the dial," says Paul Jansen, the director of McKinsey & Co.'s non-profit practice.

As this belief spreads, experts say the ranks of the mega-givers are sure to grow, especially as the largest intergenerational wealth transfer in history looms on the horizon, with at least \$41 trillion estimated to change hands by 2052—\$6 trillion of which is projected to go to charity, according to Boston College's John J. Havens and Paul. G. Schervish. Even the most youthful on the Top 50 are participating in the acceleration and mega-gift trends. Michael and Susan Dell, 39 and 40 respectively, followed pledges of

nearly \$300 million in 1999 and 2001 for children's causes with one that was more than twice that size last year. Says Cheryl Saban, 53, who with husband Haim Saban is ranked No. 46: "You get to a point where it makes you a lot happier to buy a defibrillator for a hospital than another piece of Lalique."

Already, the Top 50 donors, over the course of their lifetimes have thrown a dizzying \$65 billion at charitable causes, many of them addressing the gaping inequalities that increasingly threaten domestic society, global stability, and world peace. The spread of globalization and the post-September 11 political climate have spurred some to direct their giving overseas, a trend mirrored in the corporate sector (page 100). (Though overall international giving by donors still stands at only 2%). "There's more awareness now that perhaps there would be greater security in the world if more people had more access to ways to make more money," says Marlene Hess, head of global philanthropic services for JPMorgan Private Bank.

That's certainly Ted Turner's view. Despite losing more than \$7 billion of his fortune in the epically botched AOL Time Warner deal, the onetime media mogul is continuing to make good on his \$1 billion pledge to the U.N., stretching it out over 15 years instead of 10. Disturbed by the fact that 30,000 nuclear warheads are on hair-trigger alert, Turner has focused his recent philanthropy on reducing the number of nuclear weapons in existence and preventing the spread of new ones. "The problems need to be solved now, not in 20 years," says Turner. "If we do everything right in the next 50 years, we'll be living in a paradise. But if we don't we could be gone, or living in a hot, burning hell."

Mega-giving is also helping to take up some of the burden of foundations and other non-profits that saw their endowments crushed during the recession. Those problems were compounded by deep social spending cuts on the part of the Bush Administration. Given the gargantuan federal deficit, there's not likely to be any increase from Washington anytime soon. That means there

"You get to a point where it makes you a lot happier to buy a defibrillator for a hospital than another piece of Lalique"

The 50 Most Generous Philanthropists

RANK	NAME	BACKGROUND	2000-2004 GIVEN OR PLEDGED MILLIONS	CAUSES	ESTIMATED LIFETIME GIVING* MILLIONS	REMAINING NET WORTH** MILLIONS	GIVING AS A % OF NET WORTH***
1	Bill and Melinda Gates	Microsoft co-founder	\$10,085	Health, education, info. access	\$27,976	\$48,000	58%
2	Gordon and Betty Moore	Intel co-founder	7,046	Environmental conservation, science	7,300	3,800	192
3	Warren Buffett	Berkshire Hathaway CEO	2,721	Reproductive choice, reducing nukes	2,730	41,000	8
4	George Soros	Investor	2,301	Open and free societies	5,171	7,200	72
5	James and Virginia Stowers	American Century founder	1,346	Biomedical research	1,564	716	218
6	Eli and Edythe Broad	SunAmerica, KB Home founder	1,333	Public education, arts, science	1,570	6,000	26
7	Michael and Susan Dell	Dell founder	933	Children's health and education	1,230	14,200	9
8	Alfred Mann	Medical devices	830	Biomedical education and research	1,000	1,400	71
9	Paul Allen	Microsoft co-founder	735	Arts, culture	831	20,000	4
10	Walton Family	Family of Wal-Mart founder	650	Education	1,000	95,800	1
11	Ruth Lilly	Eli Lilly Heiress	560	Poetry, libraries, culture	750	300	250
12	Veronica Atkins	Widow of Dr. Robert Atkins	500	Eradication of diabetes	500	500	100
13	Michael Bloomberg	Bloomberg founder; NYC mayor	490	Education, medical research, arts	597	5,000	12
14	Bernard Marcus	Home Depot co-founder	432	Aquarium, Jewish causes, health	550	2,000	28
15	Donald Bren	Real estate	427	Education, environment	437	4,300	10
16	Jeffrey Skoll	Ex-president of eBay	386	Social entrepreneurs	419	4,400	10
17	Patrick and Lore Harp McGovern	IDG founder	365	Brain research	380	2,000	19
18	Pierre and Pam Omidyar	eBay chairman, founder	351	Social change	421	10,400	4
19	H.F. (Gerry) and Marguerite Lenfest	Former Suburban Cable owner	349	Higher education, arts	375	825	45
20	Kirk Kerkorian	Investor	347	Humanitarian and Armenian causes	550	5,800	9
21	Sidney Kimmel	Jones Apparel chairman	341	Cancer research, arts, Jewish causes	473	750	63
22	Irwin and Joan Jacobs	Qualcomm co-founder	312	Education, arts	450	1,700	26
23	Robert Meyerhoff	Real estate developer	304	Art, higher education	305	n.a.	n.a.
24	John Kluge	Metromedia founder	301	Library of Congress	751	11,000	7
25	Clayton and MaryAnn Mathile	Former Iams chairman, CEO	297	Youth, education, entrepreneurship	322	1,800	18
26	Jon Huntsman	Huntsman founder, chairman	290	Cancer, business education, homeless	495	2,300	22
27	Frank and Jane Batten	Landmark Comm. founder	285	Higher education	315	1,000	32
28	Sandy and Joan Weill	Citigroup chairman	280	Arts, education	315	1,400	23
29	George Kaiser	Oil & gas, banking, real estate	275	Antipoverty in Oklahoma	287	4,000	7
30	William and Claudia Coleman	BEA Systems co-founder	251	Cognitive disabilities	251	75	335
31	David Geffen	DreamWorks co-founder	233	Health, HIV/AIDS, arts	260	4,400	6
32	Tom Monaghan	Domino's Pizza founder	232	Catholic education and services	450	500	90
33	Phillip Anschutz	Anschutz Corp.	226	Hospitals, culture, children, education	450	5,200	9
34	Peter Lewis	Progressive chairman	212	Education, arts	287	1,600	18
35	Arthur Blank	Home Depot co-founder	183	Youth, arts, environment	206	1,200	17
36	Ted and Joan Waitt	Gateway founder	183	Family, community violence prevention	360	1,400	26
37	Charles and Helen Schwab	Charles Schwab	174	Social issues, education, arts	231	2,800	8
38	Alberto Vilar	Investor	162	Arts, culture	225	950	24
39	Sidney Frank	Sidney Frank Importing	160	Education, health care, arts	160	1,600	10
40	Oprah Winfrey	Harpo chairman	151	International education initiatives	175	1,300	13
41	Catherine Reynolds	Student loan business	150	Arts, education, social entrepreneurs	150	550	27
42	William and Alice Goodwin	AMF Bowling chairman	140	Cancer research, higher education	185	120	154
43	Gary and Frances Comer	Lands' End founder	133	Environment, education	136	1,000	14
44	Henry and Susan Samuelli	Broadcom chairman, co-founder	124	Education, alternative medicine, arts	174	1,500	12
45	Ted Turner	CNN founder	121	Environment, global security	1,200	1,900	63
46	Haim and Cheryl Saban	Saban Capital Group	121	Hospital, U.S. and Israeli charities	128	2,200	6
47	Ira and Mary Lou Fulton	Fulton Homes	118	Higher education, community initiatives	131	355	37
48	Kenneth Behring	Real estate	118	Smithsonian, wheelchairs	118	420	28
49	David and Cheryl Duffield	PeopleSoft co-founder	117	Animals, humane society, education	200	1,100	18
50	Martha Ingram	Ingram Industries	116	Education, arts	754	2,500	30

*Based on public records & interviews with donors **Based on Forbes 400 list & BW estimates ***Donations as a percent of remaining net worth
 Note: For an explanation of our ranking methodology, see page 90

Data: BusinessWeek GuideStar Chronicle of Philanthropy

will continue to be great pressure on individual givers, and especially on the super-philanthropists, to dig deep. "Philanthropy and the entire nonprofit sector face more challenges than at any other time in recent memory," says Jeff Krehely, deputy director of the National Committee for Responsive Philanthropy.

To suss out the new entrants on this year's list, and to create our overall ranking, we analyzed public records and conducted scores of interviews with community foundations, nonprofit experts, billionaires, fund-raisers, and wealth watchers. To qualify for the Top 50, philanthropists had to have given or pledged \$116 million in the past five years—\$21 million more than the minimum last year. That knocked off givers such as Netscape Communications Corp. co-founder James Clark and CyBerCorp founder Philip Berber and his wife, Donna. Maurice "Chico" Sabbah fell off our list after he and his business partner agreed to pay \$400 million in July to settle fraud charges, putting an end to further philanthropy. Now their creditors are trying to grab Sabbah's \$100 million pledge to the cushy American Hebrew Academy, the nation's first non-Orthodox Jewish boarding school, located in Greensboro, N.C.

Newcomers this year include Veronica Atkins, the widow of Dr. Robert C. Atkins, who pledged her entire \$500 million fortune to end the "di-obesity"—diabetes and obesity—epidemic, and Oprah Winfrey, the first African American and second self-made woman to make the Top 50. (Catherine B. Reynolds, who made her money in student loans, was the first.) Winfrey says she draws inspiration for her philanthropy, which focuses on education, from childhood experience. When she was 12, her mother told the family there was no money for even a single Christmas present. Just when Winfrey started to accept a giftless Christmas, three nuns showed up at the door with a turkey

On average, the nation's richest 1%, who own two-fifths of U.S. wealth, donate just 2% of their incomes each year

and toys. "I remember feeling that I mattered enough to these nuns—who I had never met and to this day still do not know their names—and what it meant that they had remembered me. I wasn't forgotten."

Our research this year also turned up a new force in giving that may well disrupt philanthropy in the same way eBay Inc. revolutionized commerce. Not sur-

prisingly, eBay founder Pierre Omidyar epitomizes the trend. Rather than picking one cause and creating a strategy for attacking it, his philanthropy takes a bottom-up approach, allowing individuals to determine the vision and direction in the same way the community of users do at eBay (page 96).

NO DELAY IN GIVING

BY THROWING BIG BETS at targeted causes, the mega-givers are a foil to U.S. foundations, which have been lambasted by critics and legislators for dispensing just 5% of their assets each year, including administrative costs. This enables them to maintain their "corpus," so they can operate in perpetuity, but critics say they could afford to give much more. Pointing to the delay in social benefit, a recent McKinsey study by Jansen and David Katz found that keeping all this cash on the sidelines rather than giving it out now diminishes its power to address problems by as much as 50%.

By donating virtually all of their assets to charity, and doing it during their lifetimes, many of the Top 50 also stand in contrast to their fellow wealth holders. On average, the nation's richest 1%—who own two-fifths of U.S. wealth—donate just 2% of their incomes each year, vs. 6% for families in the bottom income bracket. Fully 20% of the wealthiest estates leave absolutely nothing behind to charity. By contrast, AMF Bowling Chairman

METHODOLOGY

How the Rankings Were Reckoned

Generosity can be difficult to pin down. Many of America's most open-handed philanthropists work hard to keep their gifts quiet. Public information is rarely comprehensive. And stocks can be volatile, causing large pledges of shares to shift in value over time. So to compile *BusinessWeek's* annual ranking, we relied heavily on news reports, foundation filings, and interviews. Resources included *The Chronicle of Philanthropy*, the Forbes 400 Richest Americans, Prospect Information Network, and nonprofit GuideStar's online database of IRS foundation filings. Using

these data, we ranked the 50 Most Generous Philanthropists by what they've pledged and given in the past five years. We also estimated their total lifetime contributions and presented these figures as a percentage of each candidate's current net worth.

Pledges counted, too. The reason: We believe donors who vow to give their fortunes away in the future deserve to be lauded, not only for their generosity but also because they often inspire others to greater charitable endeavors. Still, valuing such pledges can be tricky. In many cases, the actual gift amount changes after the pledge is made. And sometimes

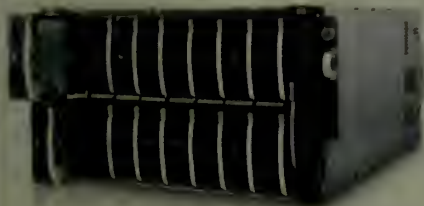
philanthropists struggle to make the payments. For example, since William and Claudia Coleman made their \$250 million pledge to the University of Colorado in 2001, their stock in the company he co-founded, BEA Systems Inc., has dropped in value by 87%. The Colemans are expected to fulfill their pledge on an extended time line. For consistency, we counted all pledges at their value at the time they were initially announced. We discounted only those that had been formally revoked.

We may have missed some big gifts. But our ranking captures the collective generosity of givers who have risen to the challenge Andrew Carnegie issued to the well-heeled in his 1889 essay, *The Gospel of Wealth*. He wrote that the goal of the rich should be to return "their surplus wealth to the mass of their fellows in the form best calculated to do them lasting good." *BusinessWeek's* Top 50 would make Carnegie proud.



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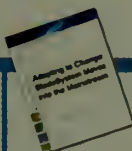
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William Goodwin and his wife, Alice, have donated three-fifths of their wealth to cancer research and education; the Moores have given almost two-thirds of theirs to conservation and science; and American Century Cos. founder James E. Stowers Jr. and his wife, Virginia, have handed over more than two-thirds of their holdings to fund the Stowers Institute for medical research in Kansas City.

Still, these individual examples of largesse aren't enough to convince everyone that the rich are doing enough. Entertainment mogul Saban lambastes those who stand sentry over their piles. Although many in Hollywood do give, he thinks the entertainment industry needs to do much more. "I think a guy like [Viacom Inc. Chairman] Sumner M. Redstone, who's worth \$8 billion, should get off the pot and start giving something rather than counting it from morning to night," says Saban during a phone interview from his Beverly Hills home. A Redstone spokesperson says: "Unlike some others, Mr. Redstone prefers to give privately. He is a significant contributor to the fights

If they aren't planned and executed well, mega-gifts can be a burden when a charity is ill-equipped to digest so much money

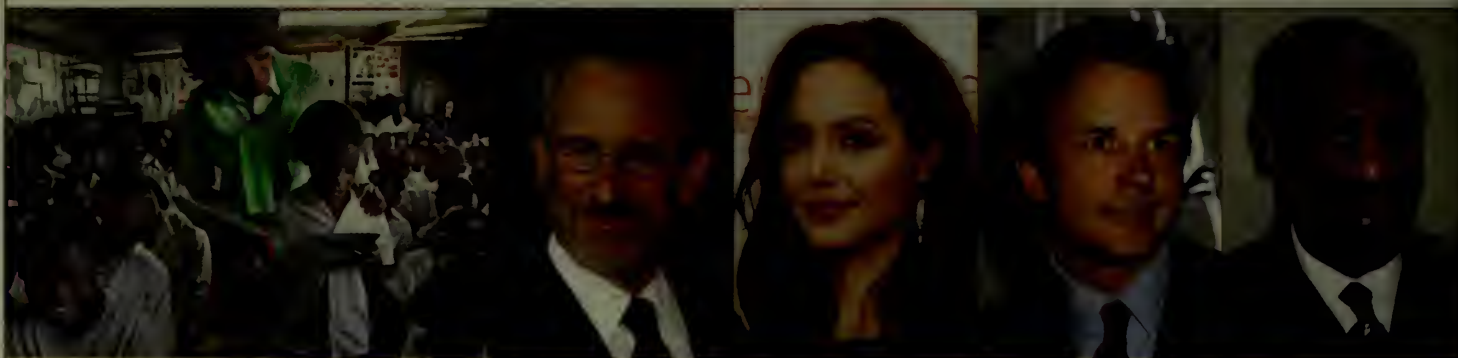
against HIV/AIDS and cancer, as well as burn-therapy programs."

That's not to say mega-gifts are always an easy solution. If not carefully planned and executed, they can turn into burdens—especially if the charity is ill-equipped to digest so much money. Some philanthropists attach strings that prove difficult for the charity to cope with. The late Joan Kroc's \$1.5 billion bequest to the Salva-

tion Army in February left the organization struggling because it had little warning of the gift. Absorbing the cash has been challenging, especially since Kroc mandated that the money be used for the building and partial operation of up to 30 new community centers. That meant none of the money could go to the 1,400 centers that already exist, many of which are in dire need of facelifts. Sometimes it's the charity that attaches strings. For years, Mann has been trying to give \$100 million to his alma mater, the University of California at Los Angeles, for a medical research institute. Finally, two years ago, Mann says UCLA attached so many caveats and clauses—with five pacts

Star Power of the Purse

When it comes to charitable giving, stars are notoriously mum about how much actually leaves their bank accounts. When asked for specifics on Tom Cruise's contributions, for example, his publicist, who is also his sister, declines to elaborate but says he prefers instead to volunteer for his favorite charities. "What's the value of a Tom Cruise hour?" she asks. There are some celebrities, though, who put their money to work, too.



OPRAH WINFREY

Winfrey is the only star who qualified for our ranking of the Top 50 most generous philanthropists. She's also the first African American philanthropist to land on the list, contributing \$175 million to educational initiatives at home and abroad. And with her Angel Network—in which 100% of audience donations go to nonprofits—she's inspiring her fans to follow in her charitable footsteps.



STEVEN SPIELBERG

The filmmaker and DreamWorks SKG co-founder's lifetime giving exceeds \$96 million. He has given away \$65 million alone in grants to support Jewish causes. One of his foundations preserves the filmed testimonies of Holocaust survivors and witnesses.

ANGELINA JOLIE

A goodwill ambassador for the U.N., Jolie recently gave \$1 million to the U.N. to aid Afghan refugees and pledged \$5 million to set up a wildlife sanctuary in Cambodia. Jolie gives a third of her income to charity, according to the Internet Movie Database Web site.



MICHAEL J. FOX

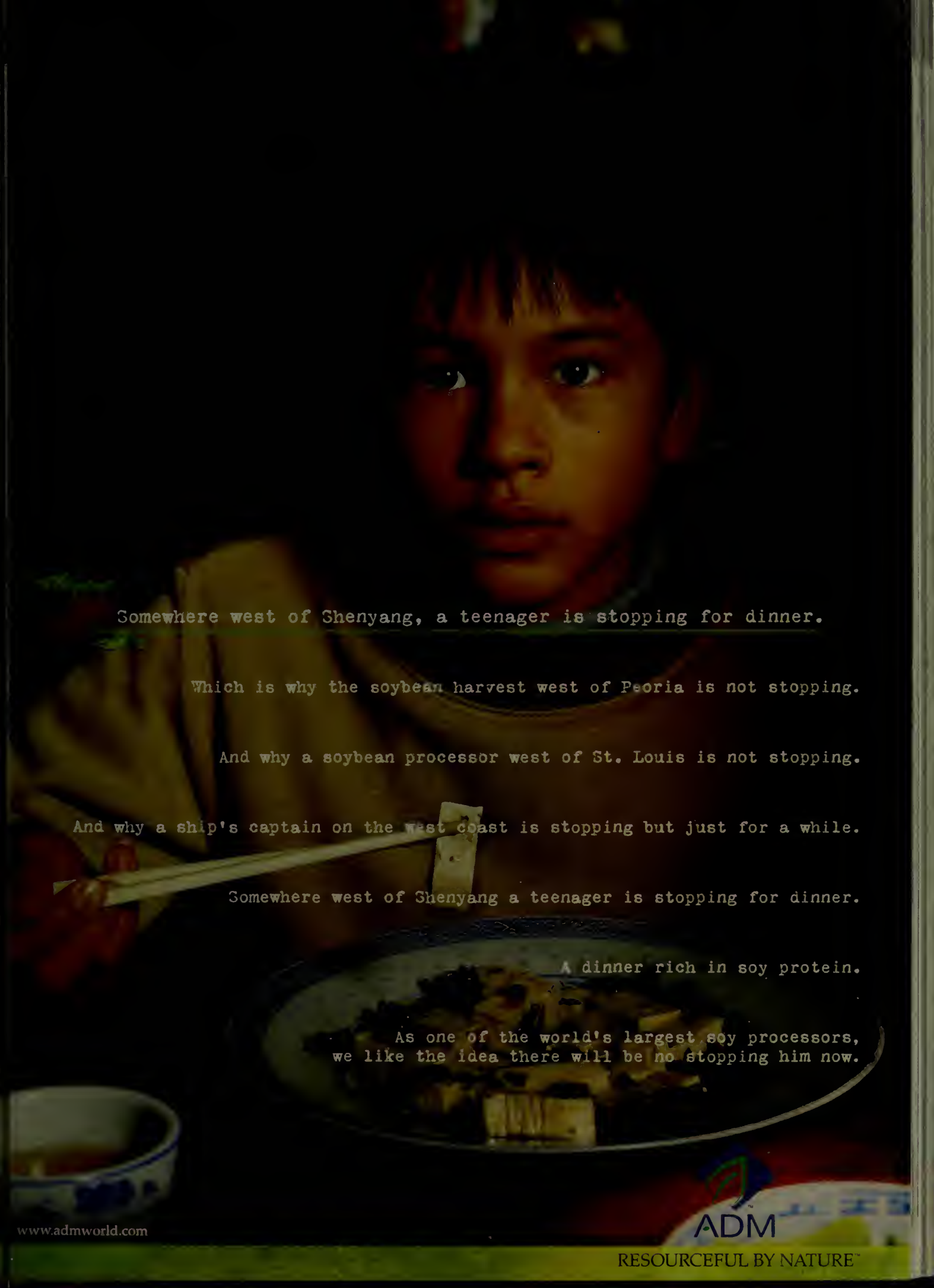
The *Family Ties* and *Spin City* star and wife, Tracy, have awarded more than \$50 million in research grants to fight Parkinson's disease through his foundation, to which he also gave nearly \$1 million in proceeds from his best-selling memoir, *Lucky Man*.



BILL COSBY

One of TV's funniest fathers is serious about academics. Cosby has donated more than \$20 million to educational causes. He will also donate profits from 10 of his live comedy shows in 2005 to the planned National Slavery Museum in Fredericksburg, Va.



A young person with bangs is shown from the chest up, looking directly at the camera while eating. They are holding chopsticks with their right hand, lifting a piece of food from a plate. The background is dark and out of focus.

Somewhere west of Shenyang, a teenager is stopping for dinner.

Which is why the soybean harvest west of Peoria is not stopping.

And why a soybean processor west of St. Louis is not stopping.

And why a ship's captain on the west coast is stopping but just for a while.

Somewhere west of Shenyang a teenager is stopping for dinner.

A dinner rich in soy protein.

As one of the world's largest soy processors,
we like the idea there will be no stopping him now.

passing back and forth between the lawyers—that what started out at 50 pages ballooned to several hundred. “I couldn’t cope with it anymore,” says Mann. “So I put it in a drawer.” Still, despite what he calls UCLA’s “intransigence,” he hasn’t given up on trying to make the gift work one day.

Mega-gifts were also on Susie Buffett’s mind. In May, shortly before she died, she gave a TV interview to Charlie Rose in which she revealed that she and her husband disagreed about philanthropy. Susie, who reveled in traveling to India for philanthropic causes and sleeping on dusty mattresses, wanted to

give more of their wealth away now; Warren thought it was better to concentrate on fortune-building so as to leave behind the biggest sum. Now, after her death, Susie Buffett’s mega-gift means she’s finally getting her wish. ■

—With Kate Hazelwood, David Polek and Tony Bianco in New York

BusinessWeek online

For more on philanthropy and interviews with some of our top givers, including Oprah Winfrey, go to www.businessweek.com/magazine/extra.htm

CHARITY

Ordinary People, Extraordinary Gifts

When Albert Lexie saw a telethon in 1981 urging viewers to give to the Free Care Fund at the Children’s Hospital of Pittsburgh, he scraped together a \$730 donation. Since then, Lexie has chipped in over \$90,000 more—saved over the course of many years from the tips he makes polishing shoes at the hospital and at local businesses. The 62-year-old, who lives on just \$10,000 a year, e-mailed President George W. Bush recently to ask if he could shine the President’s shoes. He is still waiting for a response. “He’d probably give me a \$100 tip,” muses Lexie, who shines more than 15 pairs of shoes on a typical day.

Lexie isn’t alone in sharing with others what he could very well use himself. Lower- and middle-income Americans are the unsung heroes of philanthropy: Families that have household incomes of \$100,000 or less contribute 59% of all philanthropic dollars, according to a study by the Center on Philanthropy at Indiana University.

A surprising number of the nonwealthy, like Lexie, take giving to an unusual extreme. People who give away vast proportions of their wealth, or even all of it, do so for a variety of reasons. Some have a heightened sense of social justice. They believe that wealth should be spread more evenly than it is, says Dennis Pearne, a psychologist who runs a wealth-counseling practice near Boston. Some come from the older generation of frugal spenders, who prefer to leave a legacy rather than fritter away their savings. Then there are those motivated by a sense of guilt, while still others may follow a purely capitalistic calling for many years, only

to be moved by a midlife wake-up call to do good.

Joe Temeczko illustrates the postwar penny-pinching mind-set perfectly. The wiry, gold-toothed handyman, who passed through Ellis Island en route from Poland in



LEXIE A hospital got \$90,000 of his shoeshine earnings

1950, used to roam his middle-class Minneapolis neighborhood in search of old appliances and toys that had been kicked to the curb. He would then fix what he found and give them to a church or a neighbor. Just days after September 11, Temeczko took the bus to the home of his lawyer, William Wangenstein, and changed his will so his savings would go to the City of New York. Two weeks later, Temeczko died of a heart attack. But the real surprise was that he left behind a fortune of \$1.4 million that even his lawyer didn’t know he had.

Cases of extreme giving can be found

among people who openly amass fortunes as well. A midlife crisis might inspire them, say, to give away their sports car rather than buy a new one. In some cases, once some philanthropists start giving, they can’t stop. “It can happen almost overnight,” says psychologist Pearne. Philadelphia native Zell Kravinsky and his wife built their \$45 million real estate fortune over three decades and gave nearly all of it away to public health causes in 2002 and 2003. Then Kravinsky donated one of his kidneys to a stranger; only 242 people have done the same since 1998, according to the United Network for Organ Sharing. Stephen Goldbart, co-founder of the Money, Meaning & Choices

Institute in Kentfield, Calif., says giving can become like a drug. “The more they do, the more it becomes important to them.”

There are also radical givers among the silver-spoon set. Brown University grad Karen Pittelman, 29, gave away all but \$15,000 of her \$3.4 million in family funds in 2000 to create Boston’s Chahara Foundation, which funds grassroots women’s organizations. She is now writing a handbook

for Resource Generation, a nonprofit that advises wealthy Gen Xers on giving away their money. Sudden Wealth Syndrome is the term Goldbart coined to describe a common affliction of people saddled with a windfall. “They may feel that they’re not entitled to it, that it will have a negative impact” on their lives, he says. Then there’s the social stigma that comes with being identified as wealthy. Experts say rejection by friends and a sense of social isolation is common.

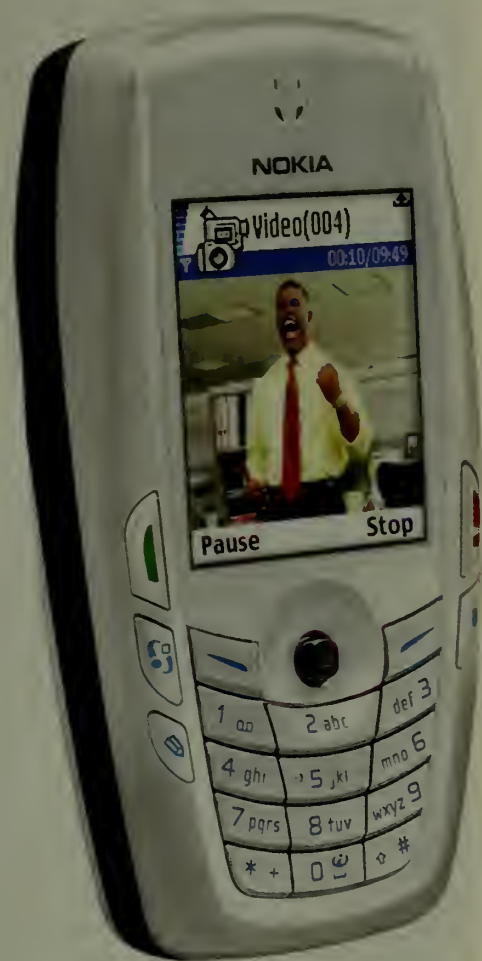
Who wants to be a millionaire? Apparently, not everyone.

—By Lauren Gard in New York



Shot at 2:34

Shared at 2:35



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AFTER BECOMING ONE OF THE RICHEST 31-year-olds in history, eBay Inc. founder Pierre Omidyar cleared out his cubicle, sold his modest home, and set off for his native Paris with his wife, Pam. It was a change born partly of the Omidyars' need to escape Silicon Valley's bubble frenzy of 1999, when they got mobbed at cocktail parties and endlessly hit on by business-plan-pushing MBAs. But the Paris chapter also stemmed from a deeper dilemma. From the moment Omidyar became rich, it was apparent to his friends that he was overwhelmingly uncomfortable—embarrassed even—by the money. “Don’t make it grow,” the accidental billionaire once told an investment adviser, so fearful was he of the burden of his multiplying commas.

In Paris, the Minitel-entranced French didn’t care much about the Web or the e-commerce mogul. So Omidyar had the time and space to sip black tea at smoky cafés and ponder his next big question. What does a ridiculously rich man with so little interest in money do? Solving the first part of the problem was easy: The Omidyars had already vowed to give away virtually all their wealth. The next part was harder: how to spend their billions and have an impact as immense as eBay’s.

Today, Omidyar’s frizzy ponytail has turned into a short, spiky haircut. The shorts and black socks worn with gnarled flip-flops have morphed into a uniform of pressed pants and leather dress shoes. The goatee is gone. And the ’96 VW has been traded in for a Mini Cooper. After the Paris sojourn, the Omidyars decided to settle with their two kids far from Silicon Valley, where it bothered them that teachers and cops can’t afford to live in the communities they serve, in favor of a gated community outside Las Vegas. In June, Omidyar, who still serves as eBay’s chairman, showed up at the company’s annual meeting in a crisp suit with a shirt and tie.

TOTAL STRANGERS

OMIDYAR’S THOUGHTS ABOUT his philanthropy have matured even more than his appearance. Just as his vision of the perfect marketplace revolutionized commerce, so too are his ideas about philanthropy likely to disrupt the rules of traditional giving. Omidyar is at the forefront of a new trend that is starting to blur the old church-state divisions between the for-profit and non-profit worlds, creating structural shifts that could lead to a new, hybrid philanthropy. In March, he shocked the philanthropic community with news that instead of investing purely in nonprofits, the Omidyar Network would house both a foundation and an arm that would also invest in for-profit companies. All the money made from the stakes in those companies—chosen by Omidyar and his team of due-diligence specialists for their emphasis on open information, giving power to the little guy, and fostering social capital—would flow back into the investing arm to leverage into yet more charitable giving. “I don’t see why we ought to make an artificial distinction that says for-profit is all about making money and only nonprofit is about helping people,” says Omidyar in an interview in the library of the network’s offices, which sit amid the thrift shops and antique stores in blue-collar Redwood City, Calif.

What influenced Omidyar most in this decision was the inspiration he took from watching eBay users learn to trust 125 million total strangers. Disabled people on public assistance turned into self-supporting entrepreneurs; Guatemalan vil-

lagers started selling their handwoven wares to people on Park Avenue. Says Omidyar: “You have to ask yourself, is it really true that business can only be about making money? And is it really true that if you want good things to happen in a community it has to be through a nonprofit?”

That’s not the only radical move Omidyar is making. In many ways, Omidyar is the anomaly among *BusinessWeek*’s Top 50 givers. Philanthropists like Bill Gates, Gordon Moore, and Michael Dell went beyond old-school giving, where you give your money to a foundation, which then doles it out for you. Instead, the new superphilanthropists applied the same brilliance that built their businesses to their philanthropic causes. They are deep on vision and heavily hands-on.

Omidyar is pioneering a third way, a philanthropy that’s fundamentally bottom-up. It’s anti-vision. Anti-dictate. And, in a sense, Omidyar isn’t even choosing how his \$10 billion is given away—or to what causes it goes. He wants you to do that. How? For starters, there’s omidyar.net, where Pierre and Pam recently opened up a conversation with the world to discuss the direction of their philanthropy. People already engaged in solving social problems know a lot more about how to fix them, they figure, than a cloistered elite ever could.

Secondly, the foundation arm of the Omidyar Network, which still hands out the vast bulk of the money, focuses on grants to individuals who are already creating social change through their nonprofits. The critical tool of these mostly smallish groups is the Internet, which enables people to take tiny ideas and give them a global launch, in much the same way Omidyar created what fans call the “first truly democratic marketplace” after selling, among other things, his broken laser pointer online. (It went for 14 bucks.)

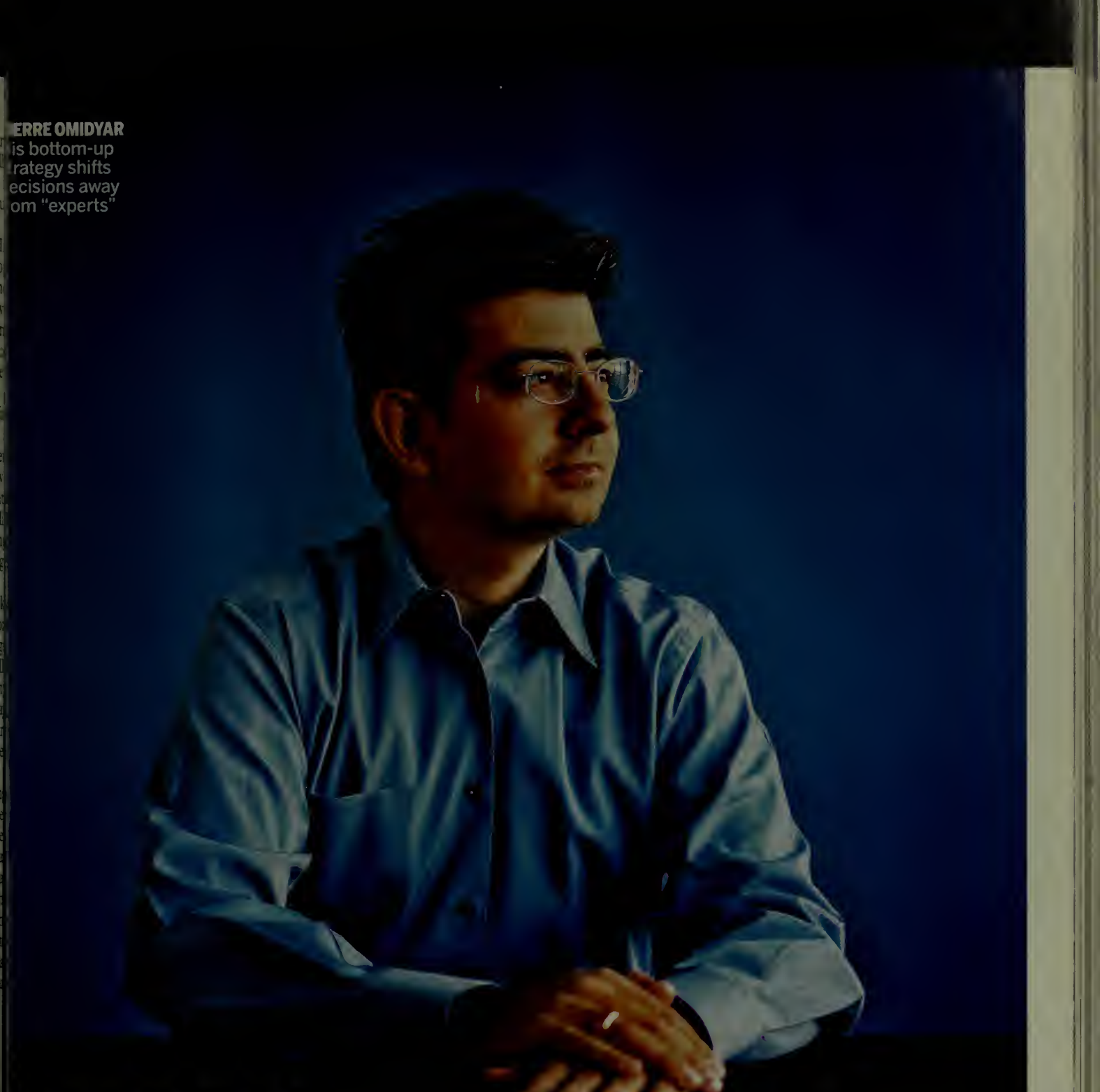
By taking out the middleman and shifting decision-making power from experts to practitioners, Omidyar believes something more efficient and innovative—and with a far bigger impact—will happen. “This is a revolution, and you can hear the ice cracking,” says Bill Drayton, founder of Omidyar grantee Ashoka, which seeds social entrepreneurs. Adds Dennis Whittle, CEO of Global Giving, another Omidyar recipient that provides an online marketplace for nonprofit projects to hook up with funders: “What I like most about Pierre is that he’s not about doing wild, wow things himself. He’s about

The site’s founder wanted to know how best to give. He asked, he listened. Here’s what he learned

BY MICHELLE CONLIN

eBay

ERRE OMIDYAR
is bottom-up
strategy shifts
decisions away
from "experts"



THE ANYWAY



KIDS GROW IN BROOKLYN
Teacher Rosado got help from DonorsChoose

enabling millions of people to do wow things themselves.”

Rather than dictating bold prescriptions, then, the nonprofits Omidyar funds flank problems, attacking them from the sides. Consider the story of the toilets. Two years ago, Whittle’s Global Giving designed a site that allowed anyone, from anywhere in the world who was properly screened and vetted, to post projects for funding. One such group was a slew of schoolteachers in Coimbatore, India. Every year, they watched scores of girls leave school when they hit puberty. And they had a sneaking suspicion as to why.

ONE SIMPLE FIX

THE TEACHERS POSTED a small, bedraggled project on Global Giving—so tiny, in fact, that it initially embarrassed Whittle, who had quit his job as a lead economist at the World Bank to start the nonprofit. The project ad read: “New Toilet Block for School. \$5,000.” Within a few weeks, four donors from around the U.S., including a writer from New York City and a banker from J.P. Morgan, put up the money. In less than three months, the school had its own separate toilet block for girls; the donors had thank-you letters and photos from the kids. Turns out the teachers had guessed right: The girls were dropping out in droves because of the embarrassment they felt once they started menstruating and had no private facilities. Now, two years later, 100 of them have stayed in school because of this tiny addition. Within 10 years, Global Giving estimates that 440 will have stayed through graduation. And the ripple effect from this one simple fix is huge, given the fact that attaining an education makes it much more likely some of these girls will eventually climb out of poverty.

With conventional giving, whether it be to the Red Cross, United Way, or small local charities—once you write your check, you’re often clueless as to any particular outcome achieved. What’s unique about

“Is That a Fact?” that asked for a set of nonfiction books. The kids were fascinated by narrative nonfiction but didn’t have a single copy of such a book in their classroom. Project cost: \$244, including shipping and fulfillment.

That was just the start. Over the course of the past year, donors from 12 states, plus Canada and Australia, have paid for 42 projects, transforming Rosado’s formerly bare classroom into one as rich in resources as that of a private school.

Omidyar’s donations to nonprofits are also making a difference abroad. With the help of the foundation arm’s donations to the Grameen Foundation USA, 1,152 women in Uganda now have their own businesses selling wireless phone time to villagers. The income enables them to build homes and send their kids to school. In India, women sell classes in computer centers, usually earning a living wage by their fifth month of operation.

Like the nonprofits Omidyar invests in, the for-profits also use technology to hand more and more power to regular people. The for-profit investing is in its earliest stages, but so far the network has invested in open-source software site Source Forge; Web-collaboration software maker Socialtext, and the gaming firm Linden Lab, creator of an online virtual world called Second Life, where users can create a virtual identity online. The game-playing allows “residents” to form social relationships. Some have even started businesses on the site that actually make money.

The Omidyars didn’t start out wanting to radicalize philanthropy. At first, they did what anyone in their situation would

do. They studied the Gates’s giving. They visited world-renowned foundations, including the Packard Foundation. There, Chairman Susan Packard Orr told them, “don’t do what we do. Do something completely different.” Little did she know just how innovative the Omidyars’ brand of giving would turn out to be. ■

—With Rob Hof in Redwood City, Calif.

Omidyar is drawn to projects that allow donors to see and choose where their money goes—and watch it have an impact

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LAST FALL PFIZER INC. PHARMACIST DENNIS Vargo left his wife and two sons in East Lyme, Conn., for a three-month stay in Kampala, Uganda. Pfizer footed the bill for the trip and paid him his full salary. In Uganda, Vargo, 50, worked for an aid group at Makerere University Faculty of Medicine and lectured on how different drugs affected patients. He advised entrepreneurial students about starting pharma companies of their own. Every Wednesday afternoon, Vargo led students on rounds of a nearby clinic to observe patients suffering from diseases that had become curable in the U.S. decades ago. Says Pfizer Corporate Affairs Senior Vice-President Robert Mallet: "People have called on multinationals to be stronger partners in the Third World, and we've accepted."

Vargo is one of Pfizer's Global Health Fellows, a group of 30 skilled professionals—from business experts to scientists—that Pfizer has loaned to aid groups in developing countries for up to six months. Informally dubbed "Hank's Peace Corps," the program started last year when Chief Executive Henry A. McKinnell Jr. decided to use the company's greatest resource—its braintrust—to address public health problems. The program pays Pfizer some hefty dividends. Global Health Fellows builds employee morale and polishes the company's reputation. And Pfizer's efforts produce some undeniably positive social results: Last year, Vargo trained all of the 18 students who went on to form Uganda's annual class of new pharmacists.

Global philanthropy is one of the hottest U.S. exports these days. Intel Corp. now has computer clubhouses providing Internet access and technology training to children in 32 countries, including South Africa, India, and, in the West Bank, the Ramallah Clubhouse. Avon Products Inc. provides breast cancer programs to 50 countries, sponsoring research, donating medical gear, and subsidizing mammograms. This year, General Electric Co. pledged \$20 million to construct 11 hospitals in Ghana. Total corporate giving abroad rose 13.82% from 2002 to 2003, according to the Conference Board's annual report on corporate contributions. International programs now account for 16% of U.S. corporate giving.

LESS DISTANCE

U.S. COMPANIES HAVE MORE REASON than ever to fund charitable causes overseas. For one, that's where much of their new business and production is headed. At least 22% of corporate revenues come from abroad. Showing a friendly face in Uganda, for example, can help when they start selling their wares there or hire a local workforce. Activists, meanwhile, empowered by the Web, have ratcheted up pressure on companies to address social issues. And with the rise of anti-American sentiment abroad, there's a sense that the problems of the rest of the world can no longer be held at a distance. Says Gap Foundation Vice-President Dotti Hatcher: "Our backyard is increasingly larger."

Altruism only goes so far in the executive suite, of course. Many CEOs subscribe to economist Milton Friedman's creed that the job of business is to make money for shareholders, who can decide for themselves which causes to underwrite. Total cash donations made by Standard & Poor's 500-stock index companies that weighed in for *BusinessWeek's* second annual survey of the top corporate givers totals \$3.26 billion. The top five individual givers alone gave \$6 billion.

For *BusinessWeek's* second annual Survey of the Top Corpo-



THE CORP

U.S. companies have discovered that global philanthropy can reap big dividends

BY JESSI HEMPEL AND LAUREN GARD



**HANK'S PEACE
CORPS** Pfizer's
McKinnell
(center) at a
clinic in Uganda

CORPORATE GIVERS

The Heavyweights

These companies make the largest cash donations, though many of them fall further down the ranking when their gifts are compared with total sales.

COMPANY	2003 DONATIONS* (MILLIONS)	COMPANY	2003 DONATIONS* (MILLIONS)
Wal-Mart Stores	\$176.0	J.P.Morgan Chase	\$86.0
Ford Motor	120.0	Bank of America	85.4
Altria Group	114.9	Pfizer	83.3
Johnson & Johnson	99.0	Wells Fargo	83.0
Exxon Mobil	97.1	Citigroup	81.4

*Fiscal year

Data: Company reports

rate Givers, we again asked S&P 500 companies to report their charitable contributions. As expected, some of the largest gave the most: Wal-Mart Stores Inc. is again our overall top giver, having hiked its 2003 gifts by 13% over 2002, to \$176 million. Also ranking in the top five a second time were Ford Motor (\$120 million), Altria Group (\$114.9 million), and Exxon Mobil (\$97.1 million). Johnson & Johnson (\$99 million) joins the elite class this year. To more accurately gauge generosity, *BusinessWeek* then ranked companies based on a ratio of their gifts to their revenues. Top cash givers on this basis were mining companies Freeport-McMoRan Copper & Gold, glass maker and telecom giant Corning, and beauty-supplier Avon Products. Top in-kind givers—that is, those who donated products and skills—were hospital chain HCA, biotech company Genzyme, and pharmaceutical giant Merck.

One-quarter of the 203 companies that disclosed their philanthropic practices told *BusinessWeek* they have international giving programs, many of which grew significantly this year. Nike Inc., for example, has increased its global gifts to 39% of overall contributions, from 20% in 2000. Citigroup has lifted its global giving to nearly 30%, roughly in line with the percentage of revenue it pulls in from abroad and up from 20% in 2000. IBM has boosted its global contributions to 30.4%, from 12.4% in 2000. That share is expected to hit 40% by 2006.

Many companies reported that their philanthropy helps in their profit-making mission by giving workers access to better health care, building employee loyalty, and burnishing the company's reputation. Take No. 10-ranked Citigroup, which has increased its sup-

port to micro lenders in developing countries over the past five years. In India alone, the company has provided grants for small loans to 900,000 women. As Citi positions itself to be the banker of choice globally, it is already building a name for itself in the developing world. In addition, CEO Charles O. Prince is trying to clean up Citi's image after highly publicized regulatory problems this year in London, Tokyo, and elsewhere. Philanthropy plays a starring role, says Citigroup Foundation President Charles V. "Chip" Raymond: "It's critical to helping us."

BAD (AND GOOD) NEWS TRAVELS FAST

EXECUTIVES SEE THIS TYPE of philanthropy as a form of social insurance in an era in which bad news about a company can circle the globe in a heartbeat. Hasbro Chairman Allen G. Hassenfeld says that if something goes wrong at the factories that make his toys, activists will use the Internet to make sure shareholders and customers know about it before he does. Philanthropy increases the chances that customers will think of the company as a good corporate citizen, softening any potential blow to its reputation. For Hasbro, which gave \$5.2 million last year in cash and products, that means years of offering grants for childhood health care and education and giving toys to needy kids.

Like Hasbro, many companies find that successful philanthropy requires going beyond monetary gifts to embrace a cause and make a visible impact. Indeed, 88% of young peo-

How Corporations Hand It Out

Companies donate in two ways: With cash and with in-kind gifts of goods and services. We ranked the most generous givers by looking at cash and in-kind gifts as a share of corporate revenues.

Most generous cash givers

COMPANY	2003* CASH GIVING (MILLIONS)	GIFTS AS A % OF REVENUES
Freeport-McMoRan	\$21.7	0.98
Corning	29.0	0.94
Avon Products	49.3	0.72
Newmont Mining	22.8	0.71
Computer Associates	15.3	0.49
General Mills	49.3	0.47
Fifth Third Bancorp	30.0	0.46
M&T Bank	13.7	0.46
Eli Lilly & Co.	51.1	0.41
Medtronic	31.0	0.40
Northern Trust	9.5	0.37
Janus Capital Group	3.3	0.34
Guidant	12.1	0.33
KeyCorp	18.6	0.33
Sallie Mae	14.1	0.32

Most generous in-kind givers

COMPANY	2003* IN-KIND GIVING (MILLIONS)	GIFTS AS A % OF REVENUES
HCA	\$821.3	3.77
Genzyme	63.0	3.68
Merck	789.0	3.51
Parametric Technology	13.7	2.04
Eli Lilly & Co.	222.3	1.77
Halliburton	251.9	1.55
Pfizer	602.9	1.33
The McGraw-Hill Cos.**	54.9	1.14
Abbott Laboratories	200.0	1.02
Oracle	91.0	0.96
Microsoft	224.0	0.70
Johnson & Johnson	285.5	0.68
Gannett	37.1	0.55
Tribune	29.1	0.52
Kellogg	34.2	0.39

*Fiscal year **Publisher of BusinessWeek

Data: Company reports

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A LOOM OF ONE'S OWN
Citi is financing women entrepreneurs in India.



ple say they believe companies have a responsibility to support social causes, according to data to be released on Dec. 1 by research group Cone Inc. Some 86% say they'll switch brands to another associated with a social issue. "Writing checks is not enough," says Steven A. Rochlin, director for research and policy development at the Center for Corporate Citizenship at Boston College. Thus, businesses increasingly publicize charitable endeavors through cause-marketing campaigns as well as in their annual reports.

"GREENWASHING"?

COMPANIES ARE ALSO GETTING more strategic about their gifts of products and skills. Years ago, in-kind gifts referred mostly to unused products. Now some companies are harnessing their

core competencies to solve social problems. Last December, IBM launched its global on-demand community, an Intranet site that allows IBM volunteers to access company technologies for volunteer projects, such as rewiring a child's classroom. The payoff: Volunteers become walking billboards for the company.

These projects also build employee loyalty and attract potential hires. A Deloitte & Touche survey says 72% of job seekers prefer to work for a company that supports a social cause. Some 85% of *BusinessWeek* survey respondents say employee morale is one of the main reasons for their philanthropic giving. "There's a war for talent, and [philanthropy] is about being competitive," says Reeta Roy, Abbott Laboratories' vice-president for global citizenship and policy.

In some industries, philanthropy is the price companies must pay to conduct business. Consider Newmont Mining Corp., the world's biggest gold producer and No. 4 on our list of cash givers. Indonesia alleges the company illegally dumped contaminated waste from a nearby mine into the ocean and sickened villagers. Activists call Newmont's community-development initiatives launched under a pact with the Indonesian government "greenwashing." They ask how projects such as eight elementary schools Newmont has built for villagers can offset the depletion of natural resources or the health hazards of improper waste disposal. A Newmont spokesperson denies having harmed villagers but concedes: "We're not perfect. But we strive to do the best we can, and we try to work with the local community as partners."

There are further practical reasons. Companies that hope to attract customers and workers in the developing world often are faced with poor health care and education. Improving those institutions through philanthropy can help lay the groundwork for future business opportunities. And true to the spirit of philanthropy, they pay impressive social dividends in the process. ■

—With Michelle Conlin, David Polek and Joshua Tanzer in New York

METHODOLOGY

Figuring Out Which Companies Gave Most

It's challenging to take the collective pulse of a field as murky as corporate philanthropy. Companies aren't required to report their contributions publicly. Even when they do, there are few agreed-on standards for valuing gifts, be they cash or goods and services.

To create our ranking, we invited all of Standard & Poor's 500 stock-index companies to tell us about their giving practices. We heard from 203 of them, or 41%. A total of 183 provided numbers for cash gifts, and 137 companies also offered figures valuing their in-kind giving. Others chose to weigh in on our qualitative questions only. We used the numbers reported to create ratios of giving to fiscal year 2003 company revenues as measured

by Standard & Poor's. We used those percentages to form our rankings of the top 15 monetary and in-kind givers.

Again this year we ranked cash and in-kind givers separately because of the challenges in valuing donations of products and services. Definitions of in-kind gifts range from material that would otherwise be thrown out to drugs created specifically for communities in need. And companies have varying standards for valuation. This year's top in-kind giver is hospital chain HCA Inc., which evaluated the amount of charitable care patients received using its pricing schedule for individuals. However, most care is paid for by insurers who get very steep discounts. Should HCA get credit for valuing its care at these elevated rates? The same

question arises for software makers: Should they evaluate the gift based on its production cost—often virtually nothing—or its consumer price, as No. 11 Microsoft Corp. does? Because there are few guidelines, companies are left to decide.

Many companies, of course, make their charitable donations through corporate foundations. To avoid double-counting, our policy is to tally the donations once—when they are made to the foundation and not when the foundation makes grants. As we calculated the data, we found that some corporations had lumped foundation grants into their overall numbers. We separated out grants where we found them. As always, we will use what we learned this year to refine our practices in the years to come.

We believe our rankings provide a snapshot of corporate philanthropy that can offer insight into how companies think about giving. Throughout this process, we benefited from the counsel and expertise of the Committee to Encourage Corporate Philanthropy, the Center for Corporate Citizenship at Boston College, and other experts in the field.

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Household Name? Not Yet

But Martin Franklin has big plans for Jarden Corp.



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IN THE 1980s, MARTIN E. FRANKLIN USED TO BE A tennis partner of Albert J. "Chainsaw Al" Dunlap, the ruthless executive who went on to gut the Sunbeam Products Inc. appliance franchise. In those days, Franklin was an ambitious but green entrepreneur, and Dunlap was working for his father's business partner, famed British corporate raider Sir James Goldsmith. Fast-forward two decades. Now Franklin, the 40-year-old CEO of publicly held Jarden Corp., is determined to resurrect Sunbeam—which Dunlap had essentially run into the ground by the late 1990s. In September, Jarden paid \$746 million for the company, which had reorganized as American Household Inc. after declaring bankruptcy in early 2001.

To Franklin, a driven entrepreneur who spices up his schedule with Ironman competitions, American Household offers a chance to turn an eclectic Rye (N.Y.) holding company into a top purveyor of consumer goods. Until now, Jarden's most exciting products were Bicycle playing cards, Diamond matches, and Lehigh twine. When the acquisition closes next year, Jarden will own Mr. Coffee, Coleman outdoor gear, Oster appliances, and several other brands that will triple the company's annual sales, to \$2.6 billion. And Franklin will be one big step closer to his goal of doubling the value of the company over the next few years and turning Jarden into a household-products stalwart on par with, say, the Clorox Co. "We can build something that's lasting and substantive," Franklin asserts.

Of course, there could be hiccups along the way. Adding durable items to a company roster made up mostly of kitchen-drawer staples will present a host of challenges. Not only will Franklin have to integrate the new brands with his other businesses, but he'll have to figure out how to hype the sex appeal of appliances, which consumers replace only every few years. Meanwhile, he has to boost margins and morale at American Household, which has struggled to recover from alleged accounting fraud and traumatic blows to its operations during the Dunlap era.

OFF THE RADAR SCREEN

AT LEAST FRANKLIN is approaching the all-important holiday selling season with a brisk wind at his back. On Oct. 29, excluding the American Household acquisition, Jarden recorded a 46% increase in third-quarter sales, to \$244.6 million, while net income rose 46%, to \$22.3 million. Those results were boosted by Jarden's July acquisition of the United States Playing Card Co. and its 2003 purchase of Lehigh, which makes everything from rope to window guards. "They get into things that are really off the radar screen, then add a little innovation and great management," says Banc of America Securities analyst Joseph Norton.

Certainly, Jarden has come a long way since 2000. That's when Franklin and partner Ian G.H. Ashken tried to launch a hostile

DEALMAKER
CEO Franklin has acquired everything from cards to cord

takeover bid of what was then Alltrista Corp., an undistinguished maker of such items as Ball jars and thermoform plastics. They intended to buy it and take it private. After

Franklin led a partnership that bought up 9.9% of shares, directors grudgingly gave him two seats on the board in June, 2001. The impatient Franklin rattled off a list of suggestions, including product innovations, cost controls, and acquisitions. The board liked his ideas so much that they soon let him run the whole thing, with Ashken becoming chief financial officer, provided they agreed to keep the company public. "It was apparent to me that they had the vision and energy to make this company more dynamic," says director Robert L. Wood, chairman and CEO of chemical company Crompton Corp. Today Franklin owns about 8% of the company, which he renamed Jarden in 2002.

Given his history as a dealmaker, analysts predict Franklin

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would sell Jarden for the right price. Arnie Ursaner, president of CJS Securities Inc., notes: "Martin is more focused on shareholder value than practically any other CEO I know." He has already increased shareholder returns by roughly 900% since he took over the top job four years ago. Although Franklin says he isn't looking to sell, he concedes that he would make a deal if he thought that would provide the best value for stockholders, including, of course, himself.

Still, Franklin insists he's having more fun as a CEO than he ever thought possible. Unlike his father, Roland, the longtime partner to corporate raider Goldsmith, Franklin seems more bent on building businesses up than breaking them apart. As the youngest of six children in a wealthy British household, Franklin could have easily slipped into the role of idle socialite. Instead, after studying political science at the University of Pennsylvania, he went to Rothschild Inc. in New York to work on deals, including some with his father. While still in his 20s, he partnered with Ashken to buy 11 optical shops for \$2.3 million. The two built the company, called Benson Eyecare Corp., into a \$350 million business. In 1996, they sold off the core operations for \$270 million, more than \$30 million of which went into Franklin's pocket, with two spinoffs later on.

Then came Jarden, where Franklin's



Mr. Coffee will be one of Jarden's marquee brands

strategy has centered around buying top-tier niche products and injecting them with a little pizzazz. For example, the company has boosted the appeal of the humble Ball Jar with such kitschy innovations as jam-making kits for kids' parties, salsa kits for adults, and Jar Art—containers that can be decorated in seasonal themes. "Martin is a pragmatic, results-oriented operator," says friend Chip Kaye, who is also co-president of Warburg Pincus LLC, which invested \$350 million in the American Household deal.

Franklin takes pride in his somewhat obsessive approach to life. When not running the company or sniffing out deals, he often trains for one of the 10 or so triathlons that he competes in each year. He even takes a regular stab at the grueling Hawaii Ironman in

Kailua Kona, which involves a 2.4-mile ocean swim, 112-mile bike race, and a 26.2-mile run. His best time: 11 hours, 45 minutes. "It's nice for my kids to see their father be so driven," says Franklin, a father of four. "I think it's inspiring for them." Franklin maintains that extreme effort—either in sport or business—is more of a spiritual than material pursuit. "It all comes down to keeping a balance to life," he says. As Jarden confronts a sudden tripling in size, striking that balance could be a challenge in the months to come. ■

—By Diane Brady in New York

BIO BOX

Martin E. Franklin

Unlike dad, Franklin is happier building up businesses than taking them apart.

BORN Oct. 31, 1964, London.

CURRENT

POSITION Chairman and CEO, Jarden Corp.

EDUCATION BA, political science, University of Pennsylvania, 1986.

UPBRINGING Youngest of six children. Father, Roland, was longtime partner to British

corporate raider Sir James Goldsmith.

FAMILY Married, four children ages 2 to 13.

OBSESSION Competes in about 10 triathlons a year, including the Ironman Hawaii and Ironman Lake Placid.

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COMMENTARY

BY MIKE FRANCE

Is There a Market for the Middle?

Nonpartisan news is vital. But it's under economic and political assault

ONE OF THE WORST by-products of our venomously partisan political culture is a growing distrust of anyone who claims to be nonpartisan. Red and blue combatants have systematically attacked the credibility of a wide variety of professionals whose jobs require objectivity: judges, pollsters, economists—and particularly journalists. Many of these ideological crusaders, in their eagerness to tip a closely divided electorate, have simultaneously worked to undermine the very professional standards that all of these occupations have developed through the decades to promote neutrality.

In the news business, things have gotten so bad that the term “mainstream media” has actually become an epithet in some quarters. Many Republicans are convinced that purportedly ob-

jective outlets such as CBS, *The New York Times*, and *The Los Angeles Times* are permanently tilted against them. Large numbers of Democrats, meanwhile, think these institutions have been so neutered by the traditional rules of balanced journalism that truly sharp analysis is available only on *The Daily Show with Jon Stewart*. Both sides increasingly get their information from ideological TV shows, radio networks, and Web sites that frequently ignore traditional ideals of editorial objectivity. As Nicholas Lemann, dean of Columbia University Graduate School of Journalism, puts it: “A lot more people are going to products called journalism that many journalists don’t consider journalism.”

Slanted content often is snappier—and cheaper to produce

All this is provoking an identity crisis among the Old Guard. As the once-faithful mass audience wanders away, Big Media is questioning its relevance—and facing a darkening economic future. The Walter Cronkite era, when a handful of blue-chip outlets had the power to define the news for the whole

country, is gone forever. The hot-growth strategy in the journalism business these days is to pander to the passionate fringe, not to try to provide balance to the indifferent middle. Consider the triumph of the rightward-leaning Fox News Channel over cable rivals CNN and MSNBC. Or the dominance of Ann Coulter and Al Franken on the nonfiction best-seller lists.

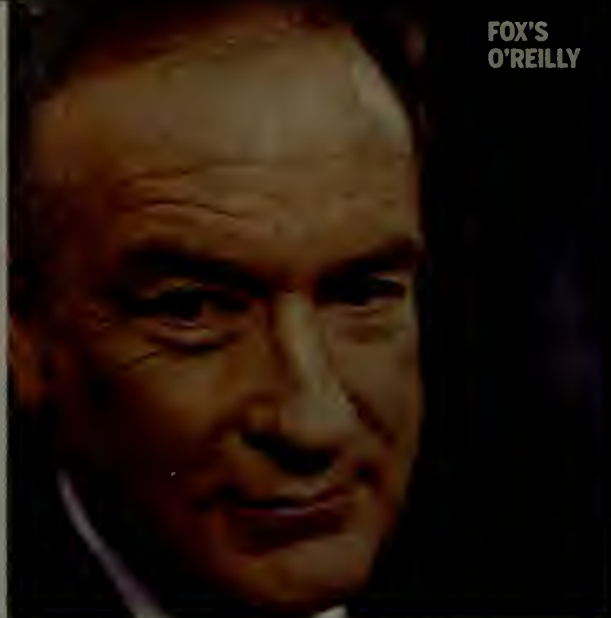
The anxious new mood was captured, the day after the election, by an article New York University journalism professor Jay Rosen wrote on his Web log, PressThink. It was titled “Are We Headed for an Opposition Press?” and examined whether America is moving toward a European model, wherein many leading papers have well-known party affiliations. This once-radical idea has suddenly gained highbrow intellectual currency based on the theory that reporters should show their true colors rather than pretend to be above ordinary human bias. Staffers at Web site Slate, for instance, disclose their party affiliations—a big taboo in the Establishment media. “The press has been pretending for too long that its old operating system will last forever,” argues NYU’s Rosen. “It won’t.”

Ideological transparency is the type of ap-



THE WAY IT WAS
Walter Cronkite personified credibility

FOX'S
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ple-pie virtue that seems impossible to oppose. But while it may be appropriate for the world of opinion media, it has the potential to be quite destructive to the fact-seeking media. If every reporter at *The New York Times* had to disclose his or her voting record, every article in the newspaper could be easily discredited on narrow political grounds. And that would be just as simplistic—in the opposite extreme—as pretending that journalists can be perfectly neutral. The truth is, reporters are more than simple slaves to their party affiliations. The same *New York Times* that some Republicans love to demonize led the charge against Democratic President Bill Clinton over the Whitewater scandal and bought the Bush Administration's scare stories about weapons of mass destruction in Iraq.

The professional guidelines that news organizations have developed through the years are more than just a form of fancy window dressing designed to disguise the hidden political agendas of reporters and anchormen. Rules for newsgathering, writing, and editing impose real restrictions on what journalists can do. "It is tempting to say that, since perfect objectivity is unobtainable, we should just say 'To hell with it' and go back to the days of nakedly partisan media," says John H. Hinderaker of the popular conservative blog Power Line. "I don't agree with that at all. It is important that there be media outlets that are reasonably unbiased [and] that are consumed equally by liberals and conservatives. Alongside them should be other news sources that are tilted in one direction or the other."

No Respect

WHILE THE PARTISAN press has a distinguished history in this country, it has never been a substitute for the mainstream media. The spadework of the Fourth Estate—investigating corruption, say, or scrutinizing 10-Ks—is still done primarily by traditional journalists. Although the American press corps has many shortcomings, it is still widely envied in countries where the news is always served with an ideological tinge. "A free press that aspires to serve as an honest broker is one of the greatest sources of American strength," says Tom Rosenstiel, director of the nonprofit Project for Excellence in Journalism in Washington. This is not just a political issue; it's a business issue. In the Information Economy, the quality of information matters.

The difficult question is not whether we need an independent media but whether the nonpartisan press will ever be able to win back the respect it has lost. A June report by Pew Research Center for the People & the Press showed that the *Times*, *The Wall Street Journal*, *Time*, *Newsweek*, and all three TV networks suffer from steadily eroding credibility. Asked if they agree with the statement: "I often don't trust what news or-

**CNN spends
\$300 million
a year to put
out the news,
vs. Fox's
\$65 million**

journalism while cutting its dramatic value. And that leads to the second issue: The plain truth is that opinionated content—such as Fox's *The O'Reilly Factor* with Bill O'Reilly—is often simpler, snappier, and less expensive to produce than objective content. According to Larry Gerbrandt, a media consultant with Los Angeles-based AlixPartners LLP, it costs CNN and CNN Headline News about \$300 million a year to put out the news, vs. about \$65 million for Fox. "It is so much less expensive to operate a news channel that is primarily studio-based rather than having a worldwide newsgathering operation with people and equipment all over the globe," says Gerbrandt. "That is an enormously expensive operation."

So this is the emerging business model: You can make money targeting a small partisan audience on cable TV or on the Web, but it's much more difficult to cash in on the traditional mainstream audience for news. That's why NYU's

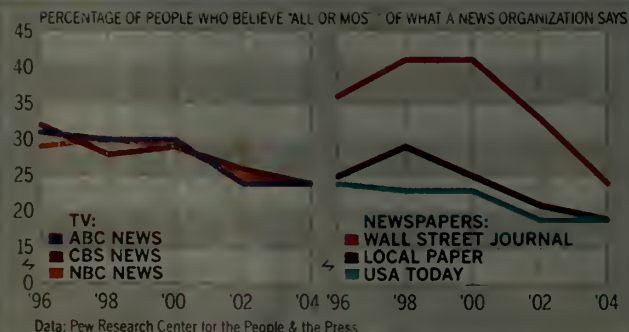
organizations are saying," 53% of Pew's respondents said yes (chart).

This is the real crisis. It has been caused in part by politically motivated outside attacks—and in part by long string of self-inflicted wounds. These include the Jayson Blair fiasco at the *Times*, Sinclair Broadcast Group Inc.'s effort to pass off anti-John Kerry propaganda as news, and the false National Guard document that CBS used to attack President George W. Bush's service record.

The political facet of this problem won't be easily fixed. Americans are becoming more ideological—and ideologues will rarely accept the fairness of pieces that criticize their position. The journalistic issue is only a little easier. Large media outlets are taking ethics more seriously, but there's still ample room for improvement. Some alienated audience members could probably be won back if the press did a better job on such things as cutting back on shallow infotainment, admitting mistakes more readily, and coming clean about inconvenient facts that don't always neatly fit the thesis of a hot story.

Problem is, imposing higher standards would drive up the cost of

BIG MEDIA CREDIBILITY IS DECLINING



Rosen speculates that CNN or MSNBC may try to attract more viewers by becoming a liberal alternative to cable leader Fox News Network. That may sound implausible, but given the overall business climate, the economic temptation to plunge headlong into the partisan fray is growing ever stronger. The independent press will never disappear completely, but it's no much of a stretch to imagine it shrinking. ■

—With Tom Lowry in New York

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Why the Flurry Of Buybacks?

Low rates and lagging prices are prompting companies to repurchase shares in a hurry

TRADITIONALLY, SHAREHOLDERS have welcomed stock buybacks. That's because such moves put money into investors' hands in a tax-efficient manner and usually presage a healthy bounce in the stock price as well. But the appeal of the high-stakes version of buybacks now being served up by Wall Street and Corporate America is much less certain.

Rather than going into the open market to buy shares gradually over several months as trading volume and free cash flow permit, more than a dozen companies this year have launched tender offers to buy roughly 10% to 20% of their stock directly from shareholders in a matter of weeks. What's more, some companies are borrowing heavily to finance all or a substantial part of their purchases, a tactic that can damage their credit standings.

On Nov. 12, for example, HCA Inc. completed what Thomson Financial says is the biggest-ever tender for a stock buyback. It offered \$2.5 billion for 13% of its outstanding stock—in just 30 days, borrowing all of the money. The stock rose 3.3% during the tender, but its bonds were downgraded to junk by Standard & Poor's and Fitch Ratings. Moody's Investors Service rated them junk already. Limited Brands Inc. is scheduled to close the sec-

ond-biggest deal, a \$2 billion stock tender, on Nov. 22, borrowing half the sum.

The appearance of big tender offers is part of a broad resurgence of stock buybacks. In the third quarter of 2004, some 175 companies announced plans to buy back stock worth \$77 billion, the highest dollar amount in four years, says Thomson. Although Microsoft Corp.'s \$30 billion buyback pumped up that number, the trend continues strong. In the first six weeks of the current quarter, an additional 70 companies announced \$54 billion worth of deals. And more will follow. Says Stefan Selig, an investment banker and vice-chairman of Banc of America Securities: "Repurchasing stock is one of the most frequently discussed corporate finance topics in boardrooms today."

What's driving the trend is a combination of low interest rates, languishing stock prices, and optimism that profits and cash flows are improving. Together, they give companies the chance to increase earnings per share by buying back stock, even if they lose interest income on the cash they use to make the purchases or have to pay interest on borrowed money.

For investors, the deals bring mixed blessings. The buying supports stock prices but makes earnings per share less reliable as an indicator of corporate performance. Because they reduce the number of shares

outstanding, buybacks mathematically increase earnings per share and make companies seem more profitable even when their income is unchanged. Bond investors tend to lose out all around. Buybacks increase corporate leverage, making existing debt more risky. Michael W. Roberge, chief fixed-income officer at MFS Investment Management mutual fund group, says assessing the risks of buybacks by companies whose bonds MFS holds is "our No. 1 focus" for 2005.

Roberge learned the hard way. His

BUYBACK BANDWAGON

The value of shares that companies are buying back is soaring





keep the stock price up.”

HCA Senior Vice-President Victor Campbell rejects the charge. He says that long before quarterly results weakened, the company had been mulling a leveraged buyback as a “prudent” use of its financial resources because interest rates were low and the company had more cash flow than it needed to keep up its business and grow in its existing markets. A tender, Campbell says, enabled the company to lock in quickly the earnings lift available from today’s low interest rates

and stock prices. HCA says its borrowing will cost an average of 4.6% on the extra \$2.5 billion of debt. After allowing for that expense, it figures that reducing its share count will boost earnings by about 15¢ a share, to between \$2.75 and \$2.90 next year.

Similar math looks enticing to other companies as well. Limited Brands is borrowing \$500 million at 5.25% for 10 years to go with other borrowing and cash to pay for its \$2 billion tender, a deal it announced on Oct. 6, along with a \$500 million special dividend and an earnings warning. Although Limited has told investors that financing the deal will cut net income by \$40 million, or 6%, the buyback would increase earnings per share by 9%, if the tender is completed at \$29. Limited did another tender for \$1 billion in April. But the debt to finance the latest deal comes at the cost of lower credit ratings. Moody’s, which cut Limited’s debt to near junk, noted that in the past the company has financed buybacks with proceeds from asset sales. Limited officials did not return calls and their investment bankers declined to discuss the deal.

Even without using debt, making buybacks through tender offers has advantages. That’s especially true for small companies, many of which see their stocks starved for attention now that Wall Street investment banks have cut back on analyst research, says Jon Einsidler, senior managing director of Georgetown Shareholder Communications Inc., a proxy solicitation firm. For instance, CPI Corp., a New York Stock Exchange-listed

company without regular analyst coverage, tendered on Nov. 12 for 13% of its stock. The company, which operates photo studios in Sears, Roebuck & Co. stores, is offering up to \$14 a share for stock that was trading at \$12 before the deal was announced. “A whole lot of companies with market capitalizations of \$100 million to \$200 million are looking at this,” says Einsidler.

BAD TIMING?

INDEED, FOR COMPANIES whose stocks are thinly traded, tenders may be the only way to buy back substantial numbers of shares without running up their price. Shares of Blyth Inc., an NYSE-listed seller of candles and home decorations, traded an average of only 270,000 shares daily before the company bought back 4.9 million shares, 11% of its outstanding stock, in a tender on July 16. “If you want to buy back a lot of your stock, tender offers can be much more efficient than open market repurchase programs,” says BofA’s Selig.

That may be true for the companies. But whether such extreme buybacks—particularly those paid for with debt—are

Taking the Plunge

To help boost prices, more companies are aggressively buying back shares over a short period of time—usually four weeks. And most are using borrowed money.

COMPANY	PERCENT OF STOCK BOUGHT	VALUE (BILLIONS)	PERCENT BORROWED
HCA	13%	\$2.5	100%
Limited Brands*	14	2.0	50
Progressive	8	1.5	0
Gartner	20	0.3	58
Blyth	11	0.2	50
United Online*	27	0.2	97

*Pending

Data: BusinessWeek

as beneficial to investors is another question. Regular repurchase programs allow companies to cut back their buying if their cash flow falters, notes Carol Levenson, director of research at Gimme Credit, an independent firm of bond analysts. That’s important for investors to remember. After all, executives can be tempted to take a chance on an aggressive buyback at precisely the wrong time—when their stock price is down because their business is weakening. ■

—By David Henry in New York



UNDER THE RATERS' RADAR? Parmalat's finance chief

The SEC also is trying to forge an agreement on a voluntary code of conduct that would set policies

about how debt analysis is done and install safeguards against insider trading and conflicts of interest. To give the code some teeth, the commission probably will ask Congress for authority to require the rating agencies to open their books and records to the SEC. "Currently there is some ambiguity about our authority to examine the agencies," says SEC Commissioner Roel C. Campos.

The SEC is acting to head off a clamor from European securities regulators for tougher rules. European authorities give the agencies a D rating for not spotting problems at troubled companies, including Parmalat, the Italian dairy giant that declared bankruptcy a year ago. The regulators are also rankled by downgrades of venerable European companies, such as German steelmaker ThyssenKrupp, by U.S. agencies.

UNFAIR CRITICISM

RATERS SAY THEY'RE faulted unfairly by critics on both sides of the Atlantic. They contend that Enron, Parmalat, and similar debacles were cases of fraud. They cite former Enron Assistant Treasurer Timothy Despain, who detailed his efforts to mislead the agencies about Enron's cash flow in a plea agreement on federal criminal charges filed Oct. 5.

The agencies agree broadly with a draft code of conduct drawn up by the Madrid-based International Organization of Securities Commissions. But some of the proposals would cripple the ratings business, they say. Take the notion of letting a company go to arbitration over a disputed grade. Companies

"would like a right of appeal to make sure their view is taken into account," explains Philippe Richard, IOSCO's secretary general. But Moody's President Raymond W. McDaniel Jr. warns that arbitration "would have a chilling effect on the independence of ratings." Agencies might feel pressure to inflate ratings to avoid litigation.

After years of citing First Amendment free-speech rights to fend off government oversight, the agencies are cooperating with the SEC. They hope that rules crafted at home will preempt the

Rating Agencies Get a Credit Check

The SEC and European regulators are debating new rules for the U.S.-led industry

CREDIT-RATING AGENCIES wield enormous power as gatekeepers to the financial markets for companies and even governments. For more than a decade, the Securities & Exchange Commission has wrestled over whether—and how—it should act as a watchdog over rating agencies, which operate largely beyond the reach of regulators. Even the barrage of criticism from Congress and bondholders that raters should have uncovered problems sooner at Enron, WorldCom, and other corporate disasters hasn't jolted the SEC into action.

Turns out that what the SEC needed was a push from overseas. European financial authorities are debating their own regulatory scheme for the American-dominated industry, and now the SEC is kicking into high gear. *BusinessWeek* has learned that the SEC is pursuing two measures to expand its limited role.

First, it is putting the finishing touches on a proposal to clarify the now-obscure process by which it authorizes rating

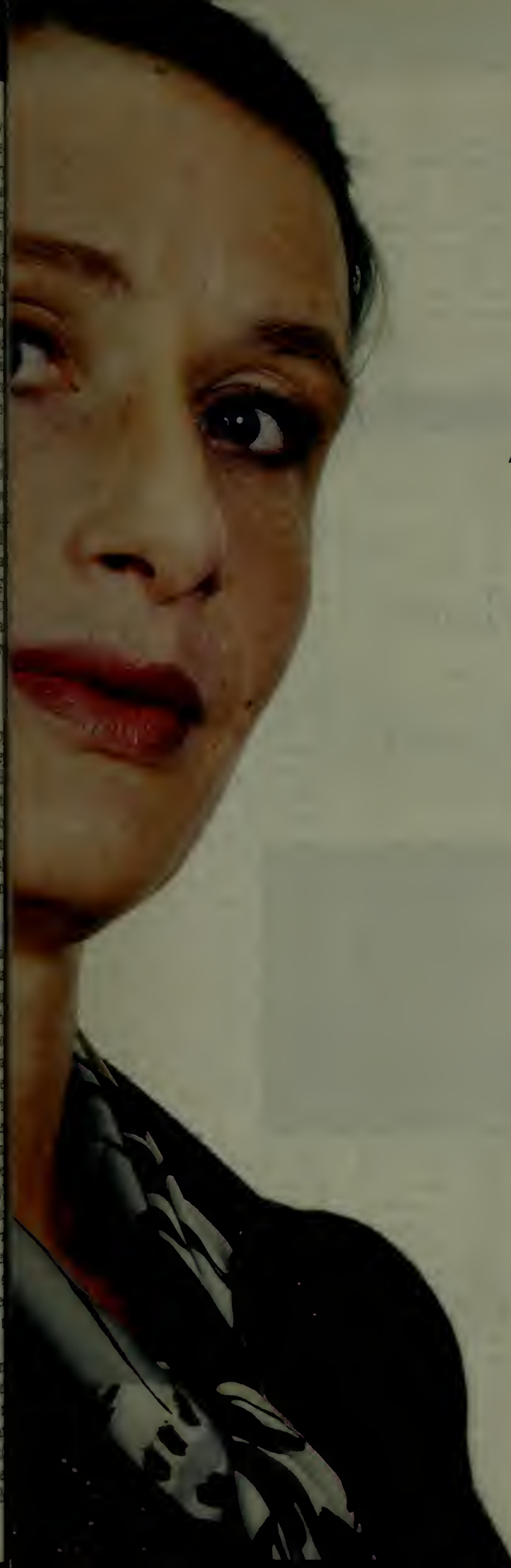
agencies to appraise the creditworthiness of corporate and government bonds. Clearer rules could allow new rivals to muscle into the club of four: Standard & Poor's (which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies), Moody's Investors Service, Fitch Ratings, and Dominion Bond Rating Service.

Tighter Scrutiny

Credit-rating agencies argue that some European proposals for regulating them would backfire because:

- Forcing them to go to **arbitration** over disputed grades would be costly and lead to inflated ratings
- Making agencies disclose **confidential information** from corporate execs could inhibit communication between raters and companies—and lead to less accurate ratings
- Requiring them to give companies more **advance warning** of downgrades would increase the risk of insider trading

Data: *BusinessWeek*



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threat of stiffer regulations abroad.

But the raters may balk at the SEC's insistence that it must be able to conduct periodic inspections to back up even a voluntary code. Raters fear SEC examiners might not stick to reviewing policies and procedures and instead start to second-guess their ratings. "It depends on the definition of what the review would be," says Vickie A. Tillman, S&P's executive vice-president for credit-market

services. "We would oppose anything that would infringe upon the rating process itself and its independence." SEC staffers say they have no intention of interfering. Amid persistent questions about the accuracy and timeliness of credit ratings on both sides of the Atlantic, the SEC believes that it's time to end its hands-off approach. ■

—By Amy Borrus in Washington,
with Laura Cohn in London

worth at least \$67.5 million, say real estate experts. If it gave up its battle for market share against the NYSE, NASDAQ and several electronic exchanges (ECNs), Amex could capitalize on the area's post-September 11 development boom and carve its distinctive 14-story Art Deco building into, say, luxury condos.

Originally called the Curb, Amex began trading on the street outside the NYSE before it moved into that building in 1926 when it won a coveted exchange license. These things are worth a bundle: Archipelago Holdings LLC, for instance, ponied up \$40 million to the Pacific Exchange in 2000, plus gave up a 10.8% equity stake to gain the Pacific's license and become a regulated exchange. An outfit like INET, the nation's largest ECN, might be tempted to buy Amex' license to avoid the long and expensive application process.

Making Amex profitable is a monumental task. In options trading, one of its main businesses, Amex has fallen to No. 3 behind the Chicago Board Options Exchange and New York's International Securities Exchange. ISE plans a public offering that bankers say could reap as much as \$750 million, a war chest that Amex cannot match. Worse yet, the ISE is lobbying hard to abolish exclusive options listings on exchanges. If the Justice Dept. and the SEC find such listings anticompetitive,

it's another nail in Amex' coffin.

Although Amex pioneered exchange-traded funds (baskets of stocks that resemble an index but trade like a single security), it is also now losing out to electronic rivals ArcaEx and INET. Even the NYSE is gaining in ETFs, winning 11% of the volume. The most heavily traded ETF—the NASDAQ-100 "Cubes"—will move from Amex to NASDAQ on Dec. 1.

Amex' small- and micro-cap companies often shine—the

Amex Composite Index, up 15%, has beaten the Standard & Poor's 500-stock index so far this year, and for the past three and five years, too. Yet Amex can't win here, either. It's now losing trading volume in its 800 listed companies to other markets. Until recently, such trading was "the only thing that kept Amex alive," says Georgetown's Angel.

Nimbler rivals and regulatory scrutiny are forcing all markets to make over their businesses. For some, that means going electronic. For others, it means going public and answering to shareholders. Amex must figure out how to make itself whole again, or head to the scrap heap as a used, albeit valuable, parts. ■

COMMENTARY

BY MARA DER HOVANESIAN

The Amex: Worth More Dead than Alive?

Maybe it's time for the exchange to auction itself off

Rumors of the American Stock Exchange's demise are back in vogue. On Nov. 11, the Amex announced that the Securities & Exchange Commission is considering civil action against three Amex executives. Chief Executive Salvatore F. Sodano, President

Peter Quick, and General Counsel Michael J. Ryan Jr. were named in an investigation into the exchange's regulation of options trading. All three, still at the exchange, declined to comment. On Nov. 17, Chief Regulatory Officer Glen Barrentine was told he is also a subject of the investigation. The Amex board named an acting CRO, though Barrentine will remain at the exchange.

When it got wind of the inquiry last year, Chicago buyout firm GTCR Golder Rauner LLC pulled out of a sweet \$110 million offer to buy the money-losing Amex from the National Association of Securities Dealers. So Amex' 834 members then voted to buy it themselves for an undisclosed amount by Dec. 1. That may not fly now because the SEC, which must approve the



WHAT AM I BID?

Amex is now losing trading revenue from its listings

buyout, is already leery about how well member-owned exchanges police themselves.

Think New York Stock Exchange.

It's time to recognize that the sum of Amex' parts may be worth more than the whole. "Amex as an institution lost its reason for being long ago," says James J. Angel, associate professor of finance at Georgetown University. "The real question is whether it should start liquidating the assets and put them to better use."

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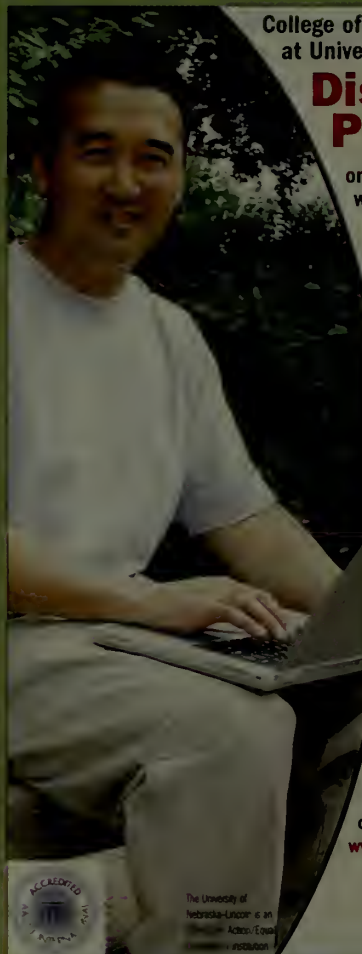
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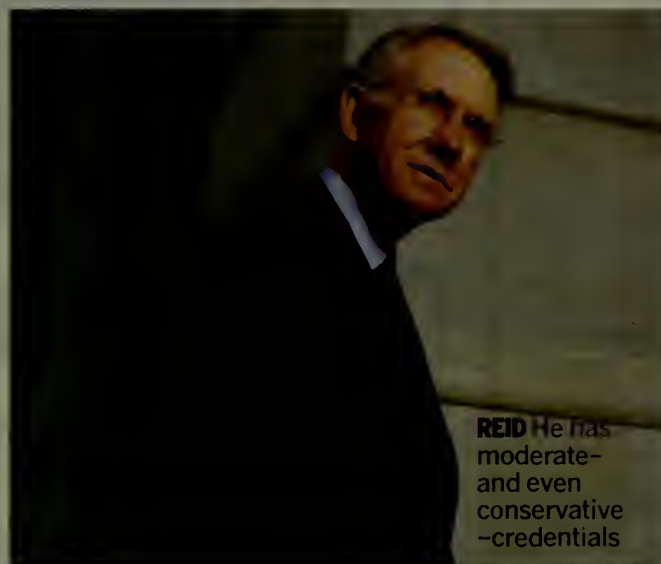
BusinessWeek

A New General For Senate Dems

They may be in better shape for battle with Minority Leader Harry Reid in charge

WHEN REPUBLICANS introduced a series of bills to ban betting on college sports, Nevada Democrat Harry Reid used his clout as Senate Minority Whip to counter with a zizzard of amendments, including one to ban such gambling in every state except Nevada. The GOP's anti-gambling effort fizzled amid the confusion. When the Bush Administration refused this year to appoint to the Nuclear Regulatory Commission a Reid ally—who also opposes a nuclear waste dump in Nevada's Yucca Mountain—Reid blocked more than three dozen Administration appointments in retaliation.

When it comes to watching out for his home state, Harry Reid is a master at holding his intimate knowledge of Senate procedures to thwart the majority Republicans. "In the art of legislative jujitsu, Reid is a black belt," says Rutgers University political scientist Ross K. Bak-



REID He has moderate—and even conservative—credentials

er. But now Reid has to go beyond local concerns and tactical skills to set his party's strategy on Capitol Hill—and its image for the nation. Elected Senate Minority Leader on Nov. 16, Reid and his shrunken Democratic caucus face a GOP emboldened by President George W.

Bush's reelection and Republican gains in Congress.

For now that will mostly mean blocking Republican initiatives. With 44 Democrats and one allied independent in the Senate, Reid has one major weapon: the threat to delay and filibuster Bush nominees and legislation. "The Democrats will be in a reactive mode for now," says Norman J. Ornstein, an expert on Congress at the American Enterprise Institute. "What they need is not a great public spokesman, but someone just like Reid who is tough without appearing abrasive and who knows how the Senate operates and can use leverage."

The low-key 64-year-old will take a quieter approach to leading the Democrats than did his smooth and telegenic predecessor, Tom Daschle, who lost his South Dakota seat on Nov. 2. Senate Republican leaders broke an unwritten rule about campaigning directly against an opposition leader and targeted Daschle for defeat, charging that he was an obstructionist liberal in a moderate's clothing. Wary Democrats are now hoping that Reid's Western roots and values will protect him from the same charges. "The Republicans won't be able to claim he's out of touch

with the public just because he resists extremist judicial appointments," says Jennifer Backus, a Democratic consultant and former Reid staffer.

FIRST TEST

IN FACT, REID can draw on moderate and even conservative political credentials—far more so than Daschle. Reid voted for the ban on partial-birth abortion, co-sponsored a constitutional amendment banning flag-burning, and voted for the 2001 USA Patriot Act, the 1990 Gulf War Resolution, and the 2003 authorization to invade Iraq. He has opposed a federal ban on assault-style weapons. And Reid, the son of a hard-rock miner, has resisted calls by environmentalists for restrictions on mining.

But when he's leading Democrats into battle, Reid promises to stick with strongly held Democratic positions. "I would rather dance than fight, but I know how to fight," said Reid, a former amateur boxer, on accepting the post on Nov. 16. His first test is likely to involve Bush's ju-

BIO

Harry Reid

The GOP will have a hard time assailing his background and values

BORN Dec. 2, 1939, Searchlight, Nev. Son of a gold miner. Mother took in laundry from many of the 13 brothels in Searchlight. Lived in a small cabin without indoor plumbing.

EDUCATION BS, Utah State University, 1961; JD, George Washington University School of Law, 1964.

POLITICAL CAREER Nevada State Assembly, 1969-71; Lieutenant Governor, 1971-75; U.S. House of Representatives, 1983-87; U.S. Senate, 1987-present; Asst. Minority Leader, 2002-present.

PERSONAL Married high school sweetheart, Landra, in 1959; five kids. Converted to the Mormon Church while in college.

dicial appointments. Chafing at Senate Democrats' refusal to approve 10 nominees to seats on federal appeals courts, Bush probably will quickly reappoint several of the conservative candidates. Even more controversial will be any nominations to replace some of the aging Supreme Court justices—with ailing Chief Justice William H. Rehnquist likely to be the first to retire.

Democrats fear most the appointment of an anti-abortion conservative who will tip the delicate balance of the court to overturn *Roe v. Wade*. Reid, though a foe of abortion himself, will resist—with filibusters if necessary—any such attempt to reverse the 31-year-old abortion ruling. Meanwhile, any efforts by Republicans to change the rules of the Senate to outlaw such delaying tactics—under consideration by the GOP leadership—would be “a huge mistake,” Reid warned.

THE DUST SETTLES

BUSH'S TOP ECONOMIC priorities could come under fire as well. Current and former staff members insist Reid will strongly resist any efforts by the Bush Administration to overhaul Social Security with private savings accounts. He'll also fight efforts to pass additional tax cuts or any tax simplification that boosts the budget deficit. “We have a huge debt in this country created during the last four years, and even Republicans are beginning to complain about that,” said Reid. On the other hand, Reid joins other Democrats who charge that the Administration's No Child Left Behind education reforms are “underfunded.”

Democrats admit they can't block everything, so some compromise is likely. Reid, a former trial lawyer, acknowledges that high insurance premiums for doctors are a growing problem. One answer: a Democratic bill to give doctors a tax credit for “exorbitant premiums.” Reid also signaled that he wants a higher minimum wage, an oft-used sweetener for Democrats voting for GOP-backed bills.

But as the dust settles from a fractional election, the political rhetoric remains rancorous. Referring to his two new deputies, Reid said on Nov. 16: “We're not three patsies. We believe in certain things, and we will fight for them.” Given his knowledge of the legislative battlefield, he should prove a dangerous opponent. ■

—By Paul Magnusson
in Washington



FOOT SOLDIER
DHL has made a splash with its cheeky ads

DHL's American Adventure

It needs to be a bigger player in the U.S.—and can afford a long campaign

NO QUESTION, THOSE cheeky DHL ads seem to be everywhere, from the New York City subways to the World Series. In a TV pitch, a FedEx worker goes on holiday, enjoying parasailing and golf—only to see DHL trucks speeding parcels to their destinations. Then there's the bus stop poster that takes a swipe at UPS: “Yellow. It's the new Brown.” And a print ad proclaims what DHL hopes is inevitable: “The Roman empire, the British empire, the FedEx empire. Nothing lasts forever.”

In short, it's war, as DHL, the \$28 billion delivery and logistics company controlled

since 2002 by Deutsche Post World Net—the privatized German postal service—fights to become a credible alternative in the U.S. to FedEx Corp. and United Parcel Service Inc. DHL is the largest express carrier in Europe with a 40% share, and the largest international express carrier in Asia, also with 40%. Now DHL, whose U.S. base is in Plantation, Fla., is seeking to build its presence by expanding its trucking routes, creating air hubs, and advertising heavily to raise awareness of its brand in a country where it has only 7% of the air and ground parcel market.

With North American express traffic accounting for nearly half the worldwide total, no carrier with global an

**Taking on
FedEx and
UPS is a
daunting
task**

tions can afford to ignore it. And DHL has set its sights on the small- and medium-size U.S. businesses that are increasingly involved in foreign trade. "It's a global economy now," says John Fellows, CEO of DHL Holdings (USA) Inc. "You have to be everywhere."

But taking on FedEx and UPS, which together command 78% of the U.S. parcel market, is a daunting task. It was only in May that the company won a bruising legal battle, when regulators turned aside challenges by FedEx and UPS that the planes DHL contracted to use here constituted illegal foreign control of an airline. Completing the integration of Airborne Inc., the Seattle carrier that merged with DHL last year, has been a massive job. And DHL's limited ground network has hurt its ability to attract domestic customers who want to cut costs by sending parcels overland rather than by air. In fact, until this year, DHL had almost no ground network in much of the Midwest and Rocky Mountain states.

The result: DHL, with \$6 billion in American revenues, projects it will lose \$630 million in the U.S. this year and \$380 million in 2005. The company has also pushed back the break-even date for U.S. operations by a year, to 2006. Even after reaching profitability, Fellows says that DHL's return on investment is unlikely to top 4% for the next few years.

CROWN JEWELS

IT'S CLEARLY GOING TO take a lot more than a snappy ad campaign to turn DHL into a winner. Analysts and investors are already raising substantial doubts about whether DHL can be a viable No. 3 in the U.S. Since the mid-1990s, Deutsche Post has acquired over 100 logistics, transport, and freight-forwarding services, and expertly integrated them to build its worldwide business. DHL and Airborne were to be the crown jewels, the acquisitions that extended its grasp into the world's richest economy. But Deutsche Post "underestimated the challenges," says Raimund Maxinger, a fund manager at Frankfurt Trust in Frankfurt.

Chief among those challenges has been the lack of ground transport capability. DHL had virtually none when it was acquired by Deutsche Post, while Airborne was just getting started. Now, with high fuel prices boosting the cost of air shipment, the parcel market in the U.S. is shifting toward ground transport, which is DHL's weakest link. So DHL is investing \$1.2 billion over the next three years in sorting centers, drop-off points, and other network improvements. Nationally,



Can DHL Deliver?

It aims to be a strong No.3 among U.S. couriers. How it plans to get there:

GET BETTER KNOWN This year DHL is spending \$150 million on a cheeky ad campaign (above) that tweaks UPS and FedEx

IMPROVE THE INFRASTRUCTURE Build stronger trucking network in Rocky Mountain and Midwest regions; open West Coast air hub

TARGET THE LITTLE GUY Focusing on midmarket and smaller businesses by offering more personal service

BOOST MARKET SHARE In five years, DHL wants 10% to 12% of the market, up from 7% today

Data: Deutsche Post World Net, BusinessWeek

for instance, DHL has only 16,000 drop-off points—about one-third FedEx' number. "It takes a lot of money and a lot of talent to build a high-quality network. That's a big hurdle," says Kurt Kuehn, senior vice-president of worldwide sales and marketing for UPS.

But DHL is determined to build out its network. "If we did not have an efficient pickup and delivery system in the U.S., it would be very tough for us to hold on to our No. 1 position in Europe and Asia," says Klaus Zumwinkel, chief executive of parent Deutsche Post and the mastermind behind its global strategy.

DHL is better situated in terms of air transport. Since 2000, it and Airborne have collectively invested \$1.9 billion in the U.S. and Canada, much of it on projects such as the consolidation of air operations at its Wilmington (Ohio) hub. Construction of a West Coast hub is under way. But those outlays only begin to get DHL into the game. "It does not close the gap," says Satish Jindel, president of transportation consultant SJ Consulting Group Inc. Over the same period, he says, FedEx and UPS each spent more than \$6 billion in North America.

In addition to its \$150 million media campaign, DHL is counting on improved customer service to build its business. While the company knows that it won't be easy to separate customers from their UPS drivers, it's trying to mold a more

customer-friendly workforce. Analysts say that task was neglected by Airborne. In one survey, DHL now rates even lower than Airborne did on customer satisfaction. To remedy that, Fellows says he's using Starbucks Corp. as a model. The coffee purveyor is known for screening workers as carefully as it screens beans. "It's training, but it's also hiring the right person," Fellows says.

Personalized service can be a winning pitch for some customers. Shoemaker Skechers USA Inc. already has shifted about a third of the business from its Manhattan Beach (Calif.) headquarters from FedEx to DHL, which it also uses for international shipments. "I've been responsible for shipping and receiving

for 13 years, and it wasn't until this past year that I met my FedEx rep. DHL is constantly out here," says Michael Cardenas, Skechers' office services manager. He also praises DHL's hustle. "UPS and FedEx are more reluctant to go to remote locations. DHL will just do it. If their driver has to sit in the parking lot and fill out the air bills, he'll do it."

For now, DHL has modest goals in the U.S. The company aims just to raise market share to between 10% and 12%, Fellows says—a statement that draws derision from competitors. "I don't think that customers will turn over their mission-critical operations to a fledgling operation whose stated goal is to become the No.3 player," says William G. Margaritis, vice-president for investor relations at FedEx. Even if DHL doesn't break even in the U.S. by 2006, don't expect it to stop trying. With a deep-pocketed corporate parent, it can keep plugging away for years. "They can afford a U.S. problem," says analyst Markus Hesse at HVB Group in Munich. Good thing, because it looks like a problem that's not going to go away soon. ■

—By Jack Ewing in Frankfurt and Dean Foust in Atlanta, with Michael Eidam in Atlanta

BusinessWeek online For more on DHL's U.S. strategy, go to www.businessweek.com/magazine/extra.htm



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SOURCING STRATEGICALLY A BETTER RETURN ON SPENDING



No matter how much revenue is pouring into your company, it doesn't help if your spending is undisciplined. Companies typically spend fully half their revenue—or more—on goods and services procured from external suppliers. With so much money going out the door, it's no surprise that businesses are beginning to recognize the value of managing their spending more intelligently.

Reining in spending is a lot harder than just cutting costs. Many organizations have adopted approaches and tools that focus on easy cost cutting—simple fixes such as automating purchase order processes, eliminating manual errors, and consolidating pricing for different corporate divisions with the same supplier. But as procurement practices become more efficient and inflation increases the cost of goods and services, companies are embracing sourcing initiatives that do more.

Variiously called strategic sourcing, supply management, and spend management, these new initiatives can not only reduce the cost of goods and services, but also get better return on money spent. "The big trend in forward-looking companies is for procurement organizations to

focus on improving operational efforts and generating better value," says Pierre Mitchell, vice president of research at AMR Research Inc., in Boston. "This isn't just about reducing purchase prices, though. Managing spending more intelligently helps companies harness the power of their supply markets in a way that generates long-term value."

The impact on the bottom line isn't bad, either. "Spend management stands alone as a business process unique in its ability to deliver positive bottom-line results," says Dave McCormick, president of Ariba Inc., in Sunnyvale, Calif. "You would need 5 to 10 times the revenue growth to achieve the same result."

Surprisingly, though, the best returns are gained not from merely pinching supplier costs, but from collaborating with suppliers to generate a better return on spending. "You certainly want to get the lowest price," says Barry Wiegler, managing director and CEO of Sourcing Interests Group, a Bell Canyon (Calif.)-based organization where members learn from one another's sourcing experiences. "But you don't want to be penny-wise and pound-foolish. You also want to help your preferred providers to thrive and to benefit from their ideas and innovations."

SEIZE THE DAY

The foundation of effective corporate spending is executive-level support. "The CEO, COO, or CFO must be committed

to providing the benefits of strategic sourcing," says Wiegler. "Otherwise, success will be limited, because some departments will perceive that they have lost their autonomy to make independent buying decisions. Without executive support, it can be hard for employees to understand that the rigor of a sourcing program is for the overall good of the company."

Once this commitment is clear, technology can be helpful in driving change throughout the organization. Vendors offer everything from compliance management to supplier

Ariba's McCormick says spend solutions go right to the bottom line.

management, analytics, benchmarking, and data management. Across the board, these tools offer tremendous payback. "The potential return on investment is huge," adds Mitchell of AMR Research. "Because the tools and technologies needed to support new sourcing initiatives are fairly inexpensive, we frequently see ROI of more than 10 times the cost of these projects."

The two most popular sources of sourcing software are enterprise resource planning (ERP) and so-called best-of-breed vendors. ERP companies offer procurement software that integrates with other back-office functions. Niche providers specialize in sourcing solutions that may have more specific and thorough application but do not always integrate with a company's existing IT solutions.

Mitchell tells his clients not to wait for ERP software to add functionality before investing in sourcing technology. "The worst thing you can do is to let the lack of technology slow down your sourcing initiative," he says. "Better to get two or three years down the road and have saved \$50 million with a niche product and then spend \$500,000 to convert to a new system, than to generate no savings in that time because you were waiting for your ERP vendor to catch up."

GETTING A GRIP ON INTANGIBLES

How should companies choose the right sourcing solution? Ariba's McCormick advises looking for a flexible solution that can provide rapid benefits. "A product that produces fast results allows you to justify further investment in your spend management initiative," he says. "The software should also provide sustainable year-over-year improvements. In addition, seek a product that provides a rich assortment of capabilities that will meet your company's changing needs."

Some software focuses not on the procurement of goods, but of services. According to the Center for Advanced Purchasing

Studies, 32% of an average company's spending is on services, a number that may reach 86% in service-intensive industries.

"Buying the right services at the best terms can save millions," explains Fabio Rosati, president and CEO of Elance Inc., a Sunnyvale (Calif.) provider of supply-management software for services. "Yet managing and tracking delivery of services is even more critical, because most of the value is realized—or lost—after the purchase is made. Did deliverables meet expectations? Was the work on time? Was the scope or cost revised before completion?"

"Improving the way companies buy and manage services requires a fresh approach," Rosati says. In an economy where even manufacturers sell goods as a service, Rosati points out, and where 20% or more of a company's workforce are non-employees, services supply-management software helps manage thousands of service relationships, monitor performance in real time, maintain audit trails, capture discounts, and match invoices to orders and contracts.

"Proactive management of the services supply chain is essential to world-class process," says Farley Blackman, vice president and general manager of global sourcing and quality for energy giant BP, in London. "The breadth of capabilities offered by the software enables increased supplier performance, management, and quality—all while delivering cost savings."

According to Rosati, the savings typically amount to between 8% and 17% of spending, with increased compliance an added benefit. "Companies that successfully address the services spending issue consider the entire services life cycle, from purchase through delivery and satisfaction," he adds.

PUT IT ON PLASTIC

Software is not the only tool available to enrich a company's sourcing initiative. Companies such as Visa U.S.A., known for its consumer credit and debit cards, also offer a selection of commercial payment solutions—procurement cards, corporate cards, and other commercial-payment and information-management tools designed for businesses. Companies that use procurement cards to expedite business purchases save an average of \$69 per transaction over traditional paper-based purchase order methods, says David Cramer, senior vice president of Visa, in San Francisco. Last year, \$335 billion was



Photo: David Toerge

Think all the way through the service for best spend results, says Elance's Rosati.



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THE WAY TO PAY

Visa U.S.A., in partnership with Deloitte & Touche and Deloitte Consulting, recently surveyed 52 large corporate and midsize companies to identify best practices in sourcing, procurement, and payment — what Visa calls the “procure-to-pay” cycle. The leaders defined six characteristics that help them optimize this cycle:

- Proactive, ongoing sponsorship by senior management for procure-to-pay initiatives
- Collaboration within the company, to ensure communication and enforcement of procure-to-pay policies and procedures
- Progressive migration toward the automation of the entire procure-to-pay information technology platform
- A focus on aggressive strategic sourcing to enhance vendor relations
- Comprehensive data aggregation and reporting to support management and enable continuous improvement of the procure-to-pay function
- Employee use of commercial purchasing cards in alignment with the company's overall procure-to-pay strategy

Source: Visa Procure-to-Pay Best Practices study

charged on commercial procurement cards, creating cost savings of more than \$23 billion for these transactions. “Most of the early successes with commercial procurement cards involved transactions that otherwise would have been paid with petty cash,” he says. “Now companies are beginning to use these cards for other larger transactions as well, including capital expenses.” For example, one client recently used Visa for a \$4 million commercial-payment transaction.

In addition to the transaction savings, companies that consolidate their procurement activities on a purchasing card have a unified source of data about their purchases. This data can be used as input into corporate accounts payable and expense reporting systems, which can enhance visibility into procurement trends, improve cash management, streamline processes, and create an audit trail, Cramer says.

Services are also available to spotlight sourcing trends and patterns—without busting the budget. Ketera Technologies Inc. offers a suite of on-demand procurement solutions for spend analysis, contract management, e-procurement, and services procurement. Its “spend analysis express” service reviews



Visa's Cramer says a corporate procurement card saves money and provides data.

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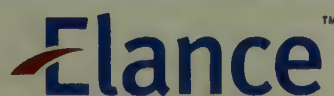
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Vought Aircraft Industries Flies High with Procurement Savings



Vought Aircraft Industries, a \$1 billion contractor to aviation giants such as Boeing, Lockheed Martin, and Northrop Grumman, found direct manufacturing costs a snap to manage, but not its \$100 million in indirect expenses.

Vought, in Dallas, employed various procurement and payment approaches, but none could communicate with the others. The company needed a centralized solution to track purchasing trends, payment mechanisms, and supplier relationships—affordably, both in terms of cost and internal resources.

Vought engaged Keteria Technologies Inc., of Santa Clara, Calif., to categorize its spending, standardize procurement operations and purchasing processes, and implement sourcing best practices. Using Keteria's hosted on-demand procurement solutions, Vought was able to aggregate spending with preferred providers, enforce preferred payment methods for specific suppliers, and reduce payment processing costs.

"Keteria is enabling us to get better line-item detail on what we're buying companywide," says Pam Stewart of Vought's material system and process integration group. "We are able to negotiate a better rate because we can guarantee suppliers a certain amount of spend."

For more information contact Keteria at 408.572.9500 or www.ketera.com



up to 15,000 accounts payable or purchase order records for \$2,500. Solutions like this can provide a fast, cost-effective entry point for midsize companies that want to set a savings baseline.

"Managing a company's spending doesn't have to require an expensive consultant or costly software," says Steve Savignano, chairman and CEO of Keteria, in Santa Clara, Calif. "What you do need is the willingness to follow up on the results, without any preconceived notions about what you will find, and change your business processes to begin driving savings."

INTIMATE RELATIONSHIPS

Whichever strategy and tools are chosen, companies must focus on the most basic goal of a strategic sourcing initiative: improving their return on spending.

Streamlining this process requires simplification. "Work with as few suppliers as possible and be as intimate as possible with them," advises Chris Smith, CEO of supply chain company RiverOne Inc., in Irvine, Calif. "Share as much information about demand as you can with your suppliers, so they can be prepared to support that. When you do both you and your suppliers will operate more efficiently and thrive."

Finally, remember that refining a corporate sourcing strategy is a work in progress. "Spend management excellence is really a journey," says McCormick of Ariba. "You can't just buy a solution and turn it on, thinking that will solve the problem. But you can use tools and services to drive change—behavioral and organizational change that will deliver great bottom-line results."

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AMR Research provides world class research and actionable advice for executives tasked with delivering enhanced business process performance and cost savings with the aid of technology. Five thousand leaders in the Global 1000 put their trust in AMR Research's integrity, depth of industry expertise, and passion for customer service to support their most critical business initiatives, including supply chain transformation, new product introduction, customer profitability, compliance and governance, and IT benefit realization. More information is available at www.amrresearch.com

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The Price Of ID Protection

Are insurance and other services for identity-theft victims worth their cost? **BY ANNE TERGESEN**

IDENTITY THEFT IS BIG BUSINESS—and not just for thieves. With more than 10 million Americans affected annually, companies are marketing insurance and credit-monitoring services designed to help potential victims maintain the good credit that's key to securing loans, opening charge accounts, and even passing employers' background checks. ¶ Buying such products might make sense if you worry about becoming a victim and think you'll want help with the cleanup. But some can be expensive. So before putting money down, weigh

the costs against the potential benefits.

Although identity-theft victims are usually not held liable for fraudulent credit-card charges, they can still pay a big price. On average, the victims of the most serious form of ID theft—which occurs when thieves run up debts in charge accounts they open in your name—spend \$1,200 and 60 hours cleaning up their credit, the Federal Trade Commission reports. Those who must take off time from

work to file police reports or make contact with creditors have even more to lose—as much as \$16,000 in wages, according to the nonprofit Identity Theft Resource Center in San Diego.

DETAILS, DETAILS

THEN, THERE'S THE emotional toll—although insurance can't help with that. "It's scary that someone is out there pretending to be you...and doing bad things," says

Jane, a New York resident who doesn't want her last name published for fear of jeopardizing a police investigation into her case. Since March, an identity thief has opened six charge accounts in her name, racking up over \$8,000 in bills.

Jane estimates she has spent \$200 on photocopies, certified letters, and travel to file police reports. Those are just some of the expenses typically covered by identity theft insurance. Available from a growing

The Prevention Solution

KEEP your Social Security number in a secure place. Never carry it around with you.

GIVE OUT your Social Security number only when necessary. Try to use other forms of identification.

DON'T ANSWER e-mail requests for your personal financial information.

40 | How the insurance scandal affects you

142 | Hiring an adviser to get into B-school

143 | Work out with a video game

145 | Barker: eBay's buying binge



Most of these policies have relatively low annual premiums—ranging from \$25 to \$40. Chubb's is even free to customers with homeowner's insurance. Since the FTC reports that the average victim spends \$500 on such items as travel and certified letters, while those who discover that new accounts have been opened in their names shell out more than twice that amount, the payoff could more than justify the cost. The argument in favor of insurance is particularly strong if you're self-employed and would forfeit substantial income if you have to take off time from work to straighten out your identity mess. "If the premium is cheap and it comes from a legitimate insurance company, it could be worth it for the peace of mind," says Edmund Mierzewski, consumer program director at U.S. Public Interest Research Group (PIRG), a nonprofit organization in Washington. Still, Mierzewski cautions that PIRG has yet to receive consumer feedback—positive or negative—on this form of insurance.

CAPPED OFF

BEFORE BUYING ANY POLICY, make sure it covers the most expensive items that victims can face, including lost wages and any fees to hire lawyers to dispute criminal charges or fight off collection agencies. Some policies cap these benefits. The insurance American Express offers its cardholders, for example, costs \$59.95 a year and covers up to \$2,000 for lost wages and \$5,000 for attorney's fees.

Although many policies have no deductible, watch out for those that do. A \$100 deductible may be no big deal if your reimbursable expenses run about average. But it can make the insurance less worthwhile if—like Jane—you have out-of-pocket costs that are minimal.

When shopping for insurance, start with the company that underwrites your homeowner's or renter's policy. Typically, insurers offer identity-theft coverage as a rider, or attachment, to such policies for an additional annual premium. Credit-card companies besides American Express offer stand-alone insurance to card-

number of insurers and credit-card companies, policies are getting more elaborate, providing for more than simple reimbursement of costs. For example, Allstate customers who have homeowner's, renter's, or condo insurance policies in Arizona, Illinois, New York, or Texas can buy coverage for about \$30 a year—the exact amount varies from state to state. It pays for someone from research and investigation firm Kroll to fill out police documents

and fix your credit report. The service is slated to go nationwide in 2005, says Allstate spokesman Bill Mellander. Along the same lines, St. Paul Travelers sells a service to businesses—who can then make it available to employees or customers—that assigns victims to case managers. They will sit in on telephone calls and otherwise assist with the recovery process, says the company's identity-theft product manager Joseph Lester.

TAKE SURE no one is eavesdropping when you're using a credit-card number over the telephone.

SHRED your discarded financial records and any pre-approved credit-card applications.

ASK credit bureaus to place a fraud alert on your file, to request that issuers check with you before giving credit.

CHECK your credit report regularly, because credit-card companies don't have to honor fraud alerts.

holders. Visa, for example, makes the insurance available to its member banks, who can then offer it to cardholders.

As always, beware of mail, e-mail, and phone solicitations, since guarding personal information is key to preventing identity theft (table, page 136, 137). "If you receive a solicitation from any source, even if it's one that appears familiar, don't provide information unless there's some means to authenticate the person who is asking for the information," says Betsy Broder, assistant director for planning and information at the FTC.

Meanwhile, credit-card companies and reporting agencies have long been offering "credit-monitoring" services. These notify

you if your credit report changes for any reason, such as the opening of an account in your name. At \$60 to \$150 a year, consumer advocates say the cost of these services is too high. "I call it a protection racket," says Mierzwinski.

GET IT FREE

INSTEAD, TAKE ADVANTAGE of a law that goes into effect between December, 2004, and September, 2005. The law, which rolls out in different states at different times, allows consumers to get one free credit report a year from each of the three major credit agencies: Experian, Equifax, and TransUnion. For maximum protection, you should stagger the

reports so that you receive one about every four months, says Shirley Rooke, president of nonprofit consumer service Call For Action.

You can get plenty of other help in resolving identity theft without spending dime. At the FTC's Web site, www.ftc.gov, you'll find detailed instructions on how to stop and prevent ID theft and restore your credit. Call For Action runs a toll-free phone service, 866 ID hotline, that's backed by Visa and staffed by counselors trained to assist identity theft victims. Of course, with some of the newest insurance products, you can have someone spare you the trouble of doing all of the dirty work yourself. ■

Computers

Mickeyfying The PC

With Disney's Dream Desk, the droll touches are pricey. **BY DIANE BRADY**

THE FIRST THINGS MY kids noticed were the protruding blue ears—cleverly housing speakers on a flat-panel monitor adorned with a flashing Walt Disney logo. "It's a mouse toy!" cried the 2-year-old. She's not far off.

Disney claims its \$950 Dream Desk PC is the only computer on the market that's ergonomically designed exclusively for kids. In partnership with frog design and Medion, the company has launched a solid and appealing package for the under-12 crowd (anyone older may feel like a dork using it). Parents will appreciate innovations such as the optical pen, which lets kids draw on a special pad, as well as a clever cable storage system that keeps plugs and cords away from little fingers.

There's a mouse for smaller hands and a host of extras you can add to the package: funky blue-and-yellow compatible

gadgets that any preteen would love. Our sitter's 9-year-old daughter was smitten with the \$99 digital camcorder, which records up to four minutes of audio and video that can be made into movies through the Disney Flix software that comes with the Dream Desk. Then there's the \$79 digital camera that works with the PC's Disney Pix software, a \$19 game controller, and a \$69 color printer, as well as other exclusive software to help kids draw and make music.

Is it worth paying \$950 for the basic PC when a cheaper machine might do the job as well—or even better? While there are no substitutes for the droll look and playful software, other machines offer more bang for the buck. A \$500 Gateway 3200S, for example, provides a similar range of features with twice the disk storage and a 17-



TOONTOWN The Dream Desk and printer (top) and digital camcorder



inch screen (vs. the 14-inch monitor for Mickey). Parents can then install an oversized mouse—KidzMouse makes dozens of types for about \$20 each—and a kid-sized keyboard for around \$70. And they can load it up with a vast range of software designed for youngsters.

While the appeal to children of the Disney Dream Desk is undeniable, it can be disconcerting to have such a critical learning tool as a computer permanently intertwined with one entertainment brand.

There's even a button on the keyboard that takes you straight to Disney's \$9.95-a-month Toontown Online site. That, combined with the constant influx of Mickey, Goofy, Donald, and the gang from all the software bundled with the machine, may sit well with young users, but it might drive their parents crazy over time. ■



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A Hired Gun for MBA Applicants?

More students are consulting advisers, spawning a controversial industry. **BY KATE HAZELWOOD**

ONLY 10% OF APPLICANTS land a spot in certain top MBA programs. So it's small wonder that many business-school aspirants don't leave much to chance—even if it means entering into an ethically gray area at best. That explains why one current applicant to Harvard Business

School hired an admissions consultant to help with his essays and to fine-tune his application. "It was beautiful," he says of the finished product, which was due on Oct. 13. "I would be very surprised if I did not get into Harvard."

The applicant will not, however, get accepted if the school finds out about the consultant. Harvard, Stanford, and Wharton require students to affirm that their application is entirely their own work. "We worry that a whole industry has developed to support people in their efforts to get admitted to Harvard Business School," says Dean of the Faculty Kim B. Clark. Many other B-school administrators say they don't like admissions consultants, even though their institutions have not gone so far as to ban them.

As many as 20% of those applying to top MBA programs are paying up to \$5,000—about \$150 to \$200 an hour—for consulting services, according to estimates from consultants and some admissions officials. What were one-

person shops less than a decade ago are now staffed with dozens of former admissions officers and MBAs from prestigious programs. "Seventy percent of our clients get into one of their top three choices," claims Toby Stock, director of MBA Counseling at Chicago's Brody Consultants.

Applicants justify using admissions consultants by saying it's no different than meeting with a paid adviser before a job interview—or showing their essays to friends or relatives for input, which school admissions offices encourage. Still, those who used consultants spoke with *BusinessWeek* only on the condition that their names not be used.

Applicants stretch ethical limits the furthest with their essays. There's a fine line between someone giving you constructive criticism and putting words in your mouth. But even critics say admissions consultants can provide services that don't raise ethical questions. They're valuable for strategizing, if you're planning to apply for an MBA a few years from now. If you have a job that's not particularly distinctive, a consultant can structure your extracurricular life to make you a more attractive candidate. An adviser also can help you get leadership experience you may lack.

PIANO DISCIPLINE

IF IT'S TOO LATE to reconstruct your life, consultants can analyze your grades, work history, and GMAT scores to gauge if you have a shot at your top school choices. If they conclude you don't, they'll steer you toward more realistic options—where you won't have to present yourself as someone you're not. If you're determined to go to a particular school despite poor odds, they can mine your life's experiences for events and character traits you can play up to offset your weaknesses. Playing the piano, for instance, might be a skill that matters more than you think. "It proves the discipline and focus we want," says Alex Brown, Wharton's senior associate director of admissions.

B-schools are getting better at spotting doctored applications. The essays have a telltale sameness to them, says Stanford's MBA Admissions Director Derrick Bolton. So if you hire a consultant, stick with approved uses. Don't forget there are other sources of help, too. "If applicants would call the admissions office, they'd get a lot of the same advice for free," says Liz Riley, admissions director of Duke University's Fuqua School of Business. Free is a value concept surely any B-school applicant can understand. ■



TOBY STOCK
Consultants can help applicants up to a point

Business schools are getting better at spotting doctored applications

I thought insomnia was keeping me up all night. Until finally,
one morning I realized it was the bank. I kept worrying about our ratings systems and
whether they really worked or not. That's why I got in touch with
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Insurance: Take a Good, Hard Look

Here's how the Spitzer investigations of the industry could affect you. **BY SUZANNE WOOLLEY**

NEW YORK STATE ATTORNEY GENERAL ELIOT SPITZER'S investigations into possible anticompetitive practices and fraud at some of the insurance industry's largest brokerage firms have led to a small miracle: They have made insurance a hot topic. And it's getting hotter, with Spitzer announcing a suit on Nov. 12 against Universal Life Resources. He charges the San Diego benefits consultant with steering business to insurers "in exchange for lucrative payoffs." Here's how your personal policies such as homeowner's and auto might have been affected by the practices Spitzer is targeting.

Are issues in the Spitzer inquiries relevant to me as an individual?

Yes. Even though Spitzer started off investigating big commercial brokers that cater mostly to large corporations, there is

a trickle-down effect on individuals. When companies pay inflated premiums, there's less money left to boost salaries and benefits for employees. It certainly costs shareholders as well.

Does the latest lawsuit bring the issue closer to home?

Yes. As in the earlier investigation focusing on Marsh & McLennan, Universal Life Resources (ULR) was accused of steering clients to favored insurers. In addition, Spitzer's complaint alleged ULR tacked an undisclosed fee on supplemental insurance policies bought by a company's employees. That fee ran \$5 to \$10 per employee per year. "What is particularly egregious in this case is that the costs of ULR's concealed payments were ultimately borne by individual employees," Spitzer said in a written statement. Says ULR's attorney: "We disagree with a number of the conclusions set forth in the complaint, and we look forward to discussing these with Mr. Spitzer's office."

What conflicts might my agent have?

Your agent may receive "contingent commissions"—incentive payments based on the dollar volume of premiums generated, renewal rates, and on the profitability of policies. In personal lines of insurance, as in the corporate world, the issue is whether these extra payments are influencing agents to steer you not to the policies that are the best combination of price and terms for you, but rather to the insurers paying them these extra commissions.

How could this affect my coverage?

If your insurance agent recommended a policy based on the contingent commissions, you might not have received the best quality coverage possible. You may, for instance, have been sold a policy from a company that makes it particularly difficult to collect on water-damage claims. Or a claim you filed under your auto or homeowner's policy might have been delayed by an agent who feared it would make his "loss ratio" for a particular period—the percentage of dollars in claims paid, measured against the premiums paid by buyers—too high. Those ratios are key in determining bonus payments.

How do I know if my insurance agent is getting a contingent payout?

You have to ask. Your agent should give you an honest and accurate answer. Amy Bach, executive director of United Policyholders, a consumer advocacy group, said her agent told her these payouts amount to 20% on top of his regular commissions. A leading association of independent agents pegs the payments at 2% to 14% of an agency's revenues.

are all authorities likely to push for more disclosure?

Insurance is regulated on a state-by-state basis, so making generalizations is difficult. But in California, for example, case law says that an agent or broker has a fiduciary duty to provide accurate information to a consumer and to be honest in response to any questions you ask. But in California, insurance commissioner John Garamendi, who has been a strong consumer advocate, is proposing new rate regulations that require agents and brokers to reveal financial incentives they get for selling certain insurance products. Other states are also trying to improve disclosure.

are all agents paid the same way?

No. Some insurance companies, such as GEICO and USAA, use salaried agents. Firms such as Allstate and State Farm use primarily "captive agents" who may be salaried or paid on commission. Either way, they sell only those companies' policies. Independent agents represent multiple carriers and can offer more choices. They collect conventional commissions from insurance companies, and they may get contingent commissions as well.

one kind of agent better than another?

In theory, independent agents have an edge because they're not limited to just one insurance company's products. But they may be tempted to direct consumers to companies that pay them the most. Truth is, you can get a good policy from any of the different types of insurance agents.

contingent commissions are eliminated, will my premiums fall?

Unlikely. Pricing that's easier to understand and compare should lead to greater competition and better policies for consumers. Insurers have been paying these extra commissions in part to gain market share, however, and may decide that if they can't get business that way, they'll increase marketing budgets and pass that cost along.

should I shop around for a new policy?

Now is a good time to sit down with your agent and review your policies. If you're looking for a new policy and are willing to do some research, work with several agents—not just one agent who presents you with three options. The key, though, is not necessarily getting the cheapest price but the best combination of cost and coverage. ■

Sweaty Video Games

New systems help keep you fit. **BY MARIA E. RECIO**

I AM A HALF HOUR INTO Mojo!, a PlayStation 2 game that requires a player to guide a zooming ball to destroy as many multicolored blocks as possible. Normally the only part of my body getting any exercise playing a computer game would be my thumb on the joystick. This time, however, my whole upper body and legs are getting a workout as I lean into a four-foot-high steering stalk that offers a fair amount of resistance.

The folks at Powergrid Fitness, who make the Kilowatt exercise machine I am testing, and others in the consumer electronics business have devised some innovative ways to combine the entertainment of video games

NOW THAT'S A JOYSTICK The Kilowatt exerciser plugs into a game console



with a brisk isometric workout.

The Kilowatt, which resembles a Segway scooter minus the wheels, plugs into standard game consoles, such as Sony's PlayStation 2 and Microsoft's Xbox. You view the action on a TV screen and use the upright steering stalk to manipulate the game. At \$799 for the sport model with 12 resistance levels and \$1,199 for the sturdier professional version with 20 resistance points, the Kilowatt is priced like a serious piece of gym equipment. Both are available from powergridfitness.com; the pro model is featured in the FAO Schwarz Christmas catalog (fao.com; 800 426-8697).

Variations on the work-up-a-sweat-as-you-play theme include an updated dancercise program for the PS2 and the XaviX system that lets you simulate competition on the tennis court, baseball field, and bowling lane.

Sony's DDR (Dance Dance Revolution), which has been on the market for a few years, features a soft step-pad that is spread on the floor in front of the TV. Players must hit the right "keys" with their feet to stay in synch with patterns on the screen and the pulsating soundtrack. Two pads can be plugged in at the same time for side-by-side dancing—a big hit with my daughters, age 12 and 9. The new DDR Extreme lets you project your image onto the screen via a digicam that plugs into a USB port. The game and pad cost \$60; the digicam is \$50.

FANCY FOOTWORK

FROM JAPAN'S SSD Co. comes XaviX with its own console and sports gear that is magical to use. The tennis game, which I liked the best, employs two scaled-down racquets with sensors that enable you to "serve" and return a virtual ball against a video opponent or another live player. The baseball game is a little trickier: It's activated by a ball that's attached to your wrist with a tether. One person can pitch, another can bat.

The otherwise cutting-edge XaviX system does have a downside: low-resolution graphics. Still, the sounds and motion dynamics are top-notch, and in no time you're drawn into the competitive aspects of the games. The price: \$79.99 for the console, \$49.99 per game. XaviX is available from www.XaviX.com and retailers such as Best Buy and RadioShack.

None of these computerized wonders will make me give up aerobics. But new-generation interactive devices are fun, draw your kids into activities, and definitely get your heart rate elevated as you huff and puff in your den. ■

EDITED BY TODDI GUTNER



RETIREMENT

The Worry Years

AH, RETIREMENT. Despite concerns among policy wonks that spendthrift baby boomers aren't salting away enough income for their golden years, the popular image remains that of a life of leisure: pursuing hobbies, visiting family and friends, and traveling to far-flung places. Maybe more people should heed the worriers.

Financial stress is the dominant theme of a **Putnam Investments** survey of 2,000 people who retired between 1998 and 2002. Some 70% said they wished they had saved more, and 59% regretted they didn't start investing earlier to meet their higher-than-anticipated expenses. Recent retirees also fretted about the stability of Social Security and Medicare. Maybe that's why a poll by insurance company **Allstate** of some 1,600 retirees and workers born between 1946 and 1978 found that three quarters of those still in the workforce say it's "somewhat likely" they will work for pay in their post-retirement years. Still, despite the money pressures, retirees from both surveys were largely satisfied with the quality of their lives. —Christopher Farrell

STOCKS

Investing overseas is always a good way to gain the benefits of diversification. But there's an even better reason to do it now. On a price-to-cash-flow basis, foreign stocks are cheaper than U.S. equities, according to mutual-fund company **MFS Investment Management**. Plus a weakening dollar should lead to price gains for foreign stocks.

—Suzanne Woolley



*PRICE-TO-CASH-FLOW RATIO OF THE MSCI EUROPE AUSTRALIA FAR EAST STOCK INDEX DIVIDED BY THE PRICE-TO-CASH-FLOW RATIO OF THE U.S. STOCK MARKET

FOOD

THE TANG OF FRESH HERBS—FROM A BOTTLE



FOR TIME-PRESSED home chefs with high standards, it's almost too good to be true: dried herbs and spices that when rehydrated in cooking taste remarkably close to fresh-picked. Thank the **Spice Hunter** of San Luis Obispo, Calif. It recently began marketing 12 Garden Harvest herbs, spices, and blends that have been flash-frozen and vacuum-dried at harvest, preserving their essential oils. Basil, dill, chives, garlic, and other ingredients, grown in the San Joaquin Valley, run \$4 for a half-ounce jar. You can find them at gourmet and natural foods stores or at spicehunter.com.

—Gerry Kherrmou

TIME OFF

FIRST AMERICAN BEAUTY

THE 300 OBJECTS on display at a new **Art Institute of Chicago** exhibit

attest to the sophistication of Native American culture in the Midwest and South between 5000 B.C. and 1600 A.D. "Hero, Hawk, and Open Hand" includes masterpieces in stone, ceramic, wood, shell, copper, silver, and gold gathered from other museums and private lenders. Among the pieces are embellished bowls, items used in native rituals, and depictions of people, fantastical animals, and abstract shapes. The exhibition runs through Jan. 30 (www.artic.edu), moves to the St. Louis Art Museum, then goes on to the Smithsonian.

—Joseph Webb





BY ROBERT BARKER

Why a Big-Spending eBay Is a Bummer

See the latest eBay ads. Take a deep, cleansing breath. "People are good," the ads say. "They're joining a community where anything is possible if we all put our mind to it, and believe. eBay. The Power Of All Of Us." A nation, a world that we lately have found so harshly divided can be, on eBay, joyfully one.

If this were 1954, someone would call it a commie plot. Instead, Planet Earth's biggest flea market aims to be our common denominator. (Whether it's our lowest, I'll leave to you; to me, it's a mystery how the Age of Aquarius turned into the Age of Auctions.) As a business, anyway, eBay has made much progress. Next year, when it turns all of 10 years old, eBay expects \$4.2 billion in revenue and nearly \$1 billion in net income. The stock, a split-adjusted \$1.50 at its 1998 initial public offering, recently popped \$110. Powering that move—and differentiating eBay sharply from busts of the Internet bubble—was steady growth in cash flow. Even after capital spending and what little it spent on acquisitions, eBay generated megabucks to spare.

UNTIL NOW. EBAY'S most recent financials reveal a notable development in how the company is seeking future growth. You can see what I mean in the table below. Since 2000, each year has brought smart increases in eBay's cash from operations, minus capital spending and acquisitions. Last year, the surplus came to \$292 million. But this year through Sept. 30, eBay had spent \$10 million more in cash than it generated. In the comparable 2003 period, it had a surplus of \$230 million.

What's going on? Acquisitions. In April, eBay spent \$152

million to buy a German classified advertising site, mobile.de. In August, it paid \$50 million for Baazee.com, an auction site in India. A month later, it raised its stake in a Korean trading site, Internet Auction, to 97% from 62% at a cost of \$485 million.

Lifted by holiday shoppers, the current quarter will surely swell eBay's cash flow. But eBay also is shopping. In October, it bought most of Internet Auction's remaining shares for \$37 million. On Nov. 11, it announced a \$290 million deal for a Dutch classifieds site, Marktplaats.nl. Whether eBay ends 2004 having generated more cash than it used is questionable. Beyond doubt is that cash flow after capital

Find the people who love what you love.



projects and acquisitions this year will plunge below levels the past two years.

Don't get me wrong. eBay is itself in no financial danger. Its balance sheet shows nearly \$2.1 billion in cash and short-term investments against less than \$125 million in borrowings. So it plainly can afford this shopping excursion. Just the same, accelerated outlays raise a couple of warning flags for those investors who have vaulted the company's market value above \$73 billion, past even American Express, never mind such humdrum retailers as Target (\$46 billion) or Amazon.com (\$16 billion).

First, the aim of anybody who owns a business is to get cash out of it. eBay easily could pay cash dividends to investors now but believes it can make the capital grow faster internally. "We expect to return excess cash to our shareholders at one point in the future," a spokesman told me via e-mail. "However, considering eBay's stage of growth, we don't believe that point is right now." Second, taking eBay's surplus cash and spending it on mostly foreign Internet sites could pay off as nicely as investing in its original domestic business has proved. But those potential rewards come at higher risks. In Taiwan, for example, eBay's auction site is locked in the kind of market-share war it never faced at home.

So, yes, go ahead. Take a deep, cleansing breath. Join the eBay believers: People are good. Just remember that when people elect to pay 17 times next year's sales and 75 times next year's earnings, they're usually good and stupid. ■

E-mail: rb@businessweek.com

In the Mood to Shop

	2000	2001	2002	2003	2004*
Cash Flow from Operations	\$100	\$252	\$480	\$874	\$904
Capital Spending	50	57	139	365	210
Acquisitions	0	112	59	216	704
Cash Flow after Capital Spending and Acquisitions	50	83	282	292	-10

In millions. *Nine months ended Sept. 30. Data: Company reports



BY GENE G. MARCIAL

ANOTHER BUMPER CROP MAY LIE IN STORE FOR TRACTOR SUPPLY.

BIOLASE: BETTER LASERS COULD BRIGHTEN UP ITS SALES.

BUYOUT TALK IS BOOSTING WEB FINANCIAL SITE THESTREET.COM.

Tractor Plows Ahead

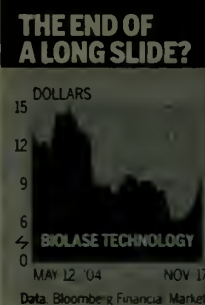
WHEN TRACTOR SUPPLY (TCSO) was mentioned here on July 14, 2003—at a split-adjusted 23.65 a share—some wondered if it was near its peak. Four months later the stock had leaped to 45, in part due to a sharp rise in farm income. But this year the farm-and-ranch outfitter—with 500 stores in 30 states selling small tractors, animal food, and garden tools—has slumped: It's down to 36.26. Although sales stayed strong, profit margins softened in the third quarter as fuel prices spiked and hurricanes interfered with deliveries. "Such events offer a great buying opportunity for this usually high-flying stock," says Marion Schultheis, managing director at J&W Seligman, who has added to her firm's stake. She says Tractor has raised prices to offset its higher fuel, steel, and freight costs. Schultheis sees the stock hitting 50 in a year, based on her earnings estimates of \$1.58 a share on sales of \$1.7 billion in 2004, \$1.96 on \$1.9 billion in 2005, and \$2.53 on \$2.3 billion in 2006. Frank Brown of SunTrust Robinson Humphrey, which has done business with Tractor, rates it a buy. He says it "has the management and infrastructure" to grow bigger.



Will More Dentists Ask for Biolase Drills?

AMANAGEMENT SHAKEUP and a new product at Biolase Technology (BLTI) have rekindled interest in the stock, which has been in a deep funk. After hitting 21.39 on Jan. 21, it skidded to 5.91 in October. But it has since moved up to 9.08. Biolase makes laser dental drills—quieter and less painful than conventional ones. An accounting change and the disruption of sales events in Florida and Louisiana by hurricanes battered earnings in the past two quarters. The management revamp "is very positive," says Dalton Chandler of investment firm Needham, which has done banking for the company. Chief Operating Officer Robert Gordon was elevated to CEO, replacing Jeffrey Jones, who is now vice-chairman and chief tech officer. The new team, says Chandler, plans to spread awareness of the advantages of laser dentistry and broaden the use of its enamel-cutting technology in specialties such as orthopedics.

A new dentistry product, Waterlase MD, launched on Oct. 1, is easier to use and more effective than the old model—and sells for \$70,000, up from \$50,000, he says. He expects 2004 earnings of 4¢ a share, on sales of \$59 million, and 22¢ on \$88.6 million in 2005, vs. 2003's 83¢ on \$49 million. Peter Cardillo of S.W. Bach, which owns shares, sees the stock at 16 in a year as earnings recover fully.



Why a Suitor May Click On TheStreet.com

AN ANEMIC PERFORMER, TheStreet.com (TCSM), has perked up lately. The stock rose from 3.42 in early November to 4.06 on Nov. 17. (It hit 60 in May, 1999.) Behind the uptick now: takeover talk. Dow Jones is buying MarketWatch, outbidding Yahoo!, Viacom, and *The New York Times*. A New York investor with a big stake in TheStreet.com says: "People are knocking on its door." He says shares are worth twice their current price, if valued at the 6.5 price-to-sales ratio in the MarketWatch deal. Frank Gristina of Avondale Partners says any of the three who lost out may go after TheStreet.com. Co-founded by TV commentator and investment pro James Cramer, who owns 15.5%, TheStreet.com provides financial info over the Net. Its income comes mainly from ads and subscriptions. The company has yet to make money. CEO Thomas Clarke Jr., who owns 13.5%, "would not be opposed to selling at the right price," says Gristina, who rates the stock "outperform." In 2005, Gristina sees TheStreet.com earning 18¢ a share on revenues of \$40.1 million, up from an estimated \$35 million in 2004, and \$26 million in 2003. Clarke didn't return a phone call. Catherine Mathis of the *Times* declined comment, as did spokesmen for Viacom and Yahoo.

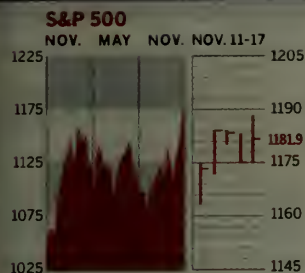


BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Personal Business Figures of the Week

STOCKS



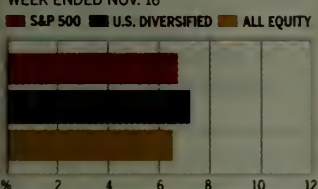
COMMENTARY

Markets steadily advanced this week as key indicators pointed to a solid U.S. economy. Housing starts and industrial production rose, but higher consumer prices rose in the three months through October, the declining dollar—which set a new low on Nov. 17—and higher oil prices continued to dampen all-out enthusiasm. Still, the Dow and S&P gained 1.6%; the Nasdaq was up 3.2%.

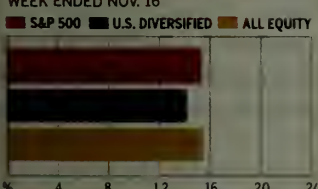
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	NOV. 17	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1181.9	1.6	6.3	13.3
Dow Jones Industrials	10,549.6	1.6	0.9	8.6
NASDAQ Composite	2099.7	3.2	4.8	10.0
S&P MidCap 400	635.1	2.2	10.3	14.9
S&P SmallCap 600	316.1	2.0	16.9	23.0
DJ Wilshire 5000	11,585.8	1.8	7.3	13.9

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	685.4	2.1	10.2	14.2
BW Info Tech 100**	362.3	4.1	3.4	10.5
S&P/BARRA Growth	572.2	1.9	2.9	8.2
S&P/BARRA Value	605.4	1.4	9.7	18.4
S&P Energy	282.7	0.9	26.1	45.0
S&P Financials	398.7	1.1	5.0	11.2
S&P REIT	136.8	1.1	18.1	21.5
S&P Transportation	232.8	0.8	15.3	17.2
S&P Utilities	138.4	0.8	16.9	26.8
GSTI Internet	161.4	1.6	11.6	21.0
PSE Technology	752.1	3.2	7.9	13.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	NOV. 17	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1324.5	2.6	12.4	26.2
London (FT-SE 100)	4795.9	1.3	7.1	10.5
Paris (CAC 40)	3844.1	1.6	8.0	14.4
Frankfurt (DAX)	4183.4	2.3	5.5	13.8
Tokyo (NIKKEI 225)	11,131.3	1.2	4.3	12.5
Hong Kong (Hang Seng)	13,825.0	1.1	9.9	14.9
Toronto (S&P/TSX Composite)	8987.6	1.6	9.3	15.7
Mexico City (IPC)	12,020.4	1.9	36.7	41.6

FUNDAMENTALS

	NOV. 16	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.96%	1.65%	1.66%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.9	19.8	26.3
S&P 500 P/E Ratio (Next 12 mos.)*	16.6	16.4	17.5
First Call Earnings Revision*	-0.51%	-0.16%	-0.77%

*First Call Corp.

TECHNICAL INDICATORS

	NOV. 16	WEEK AGO	READING
S&P 500 200-day average	1120.7	1119.7	Positive
Stocks above 200-day average	72.0%	70.0%	Negative
Options: Put/call ratio	0.62	0.68	Neutral
Insiders: Vickers NYSE Sell/buy ratio	4.97	4.55	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Agricultural Products	21.9	105.1
Health-Care Distributors	20.8	92.7
Steel	20.1	83.2
Internet Software	19.6	80.4
Wireless Services	17.8	75.0
Fertilizers & Ag. Chems.		

WORST-PERFORMING GROUPS

	LAST MONTH %	LAST 12 MONTHS %
Insurance Brokers	-5.3	-30.4
Office Svcs. & Supplies	-4.0	-27.8
IT Consulting	-3.8	-25.5
Photographic Products	-3.8	-25.5
Semiconductor Equip.	-1.2	-18.3
Semiconductors	-0.8	-16.1
Airlines		

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	10.2	Natural Resources	41.4
Technology	8.6	Latin America	38.0
Small-cap Growth	8.4	Real Estate	30.9
Small-cap Value	8.1	Utilities	30.4
LAGGARDS		LAGGARDS	
Natural Resources	3.7	Precious Metals	2.9
Domestic Hybrid	3.9	Technology	4.2
Japan	4.3	Large-cap Growth	9.7
International Hybrid	5.0	Domestic Hybrid	10.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Fidelity Sel. Mcdl. Del.	21.3	ProFds. Wriss. Ultsr. Inv.	93.4
ProFds. Ult. Sm. Cap Inv.	19.0	ProFunds Energy Ushr. Inv.	71.0
ProFds. Intnet. Ultsr. Inv.	18.4	iShares MSCI Austria Idx.	66.3
ProFds. Smicdr. Ultsr. Inv.	17.1	U.S. Gbl. Accde. E. Eurpn.	58.8
LAGGARDS		LAGGARDS	
ProFds. USh. Sm. Cap Inv.	-16.3	GMO Emerg. Mkts. Qty. III	-36.6
ProFds. USh. Mid Cap Inv.	-14.3	Thurlo Growth	-35.9
ProFunds UltSh. OTC Inv	-13.5	ProFds. Smicdr. Ultsr. Inv.	-33.9
Rydex Dyn. Vent. 100 H	-13.5	Ameritor Investment	-32.4

INTEREST RATES

KEY RATES	NOV. 17	WEEK AGO	YEAR AGO
Money Market Funds	1.42%	1.36%	0.61%
90-Day Treasury Bills	2.12	2.07	0.94
2-Year Treasury Notes	2.83	2.84	1.87
10-Year Treasury Notes	4.14	4.25	4.24
30-Year Treasury Bonds	4.84	4.97	5.08
30-Year Fixed Mortgage †	5.73	5.70	5.69

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.59%	4.56%
Taxable Equivalent	5.13	6.51
Insured Revenue Bonds	3.79	4.64
Taxable Equivalent	5.41	6.63

THE WEEK AHEAD

EXISTING HOME SALES Tuesday, Nov. 23, 10 a.m. EST »

Existing home sales in October are forecast to have held steady at an annual pace of 6.75 million. That's according to the median forecast of economists surveyed by Action Economics.

DURABLE GOODS ORDERS

Wednesday, Nov. 24, 8:30 a.m. EST » New durable goods orders in October probably increased by 0.3%, after a 0.2%

gain in September. The recent headline number has been dragged down by drops in aircraft orders. Exclude the aircraft sector and the September rise in new orders was 0.8%.

INITIAL UNEMPLOYMENT CLAIMS Wednesday, Nov. 24, 8:30 a.m. EST »

New filings for state unemployment claims most likely fell slightly to about 325,000 over the week ending Nov. 20, from 333,000 for the week ended

Nov. 6. The current levels of jobless claims are in line with healthy job growth.

NEW RESIDENTIAL SALES

Wednesday, Nov. 24, 10 a.m. EST »

New single-family home sales most likely inched down to an annual pace of 1.2 million in October, after a pace of 1.21 million in September. That level would keep new home sales on track to break the one million mark for a second straight year.

The BusinessWeek production index nudged up to 230.9 for the week ended Nov. 6, an increase of 12% from a year ago. Before calculation of the four-week moving average, the index slipped to 231.2.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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RYSON

INTERNATIONAL, INC.

Booth #2806

The Ryson Spiral Conveyors represent a new concept in vertical conveying. Based on a proprietary low friction chain slat arrangement, they provide continuous vertical product flow and feature a small footprint, high throughput, low maintenance and long life.

Most spirals are shipped in one piece, pre-assembled and pre-tested, which reduces the time and cost of installation. All spirals can be delivered in powder painted carbon steel, stainless steel or washdown versions, suitable for food handling.

The Ryson Spiral Conveyors only need one drive motor, even for units several stories tall. This provides substantial savings in controls and systems integration. The spirals con-

vey loads up or down in a continuous flow, thereby facilitating high throughput. The standard load capacity is 75 pounds per linear foot of conveyor for speeds up to 200 feet per minute.

Ryson is one of the world's leading suppliers of vertical conveying solutions. We manufacture high quality material handling equipment, including spiral conveyors, spiral curves, continuous lifts, accumulation buffers, bucket elevators, incline and decline slat conveyors. Give us a call or click on to www.ryson.com for additional information.



Yorktown, VA
757.898.1530
www.ryson.com

RETROTECH

INCORPORATED

SUPPLY CHAIN TECHNOLOGY

Booth #2323

Retrotech supplies solutions by applying a variety of material handling products and software. Retrotech's non-manufacturer status allows designs to be applied as best suited to a problem.

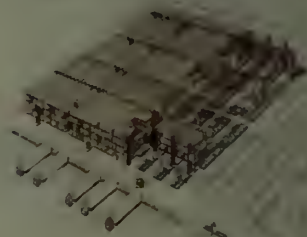
Supply Chain Enabler: One such solution, ACTIV Systems, enables supply chain improvement. ACTIV's "intelligent" software monitors trends and adjusts activity to meet changes. ACTIV adjusts for unanticipated performance without major costs for equipment additions and construction. Changes due to customization, SKU proliferation, and higher order volumes are through incremental modifications.

Redesigning Networks: A laundry products manufacturer dramatically reduced overall supply chain costs using a (4) site ACTIV high-turn strategy - 7x24. A food manufacturer installed ACTIV Systems at (2) sites

during a supply chain consolidation. one refrigerated food service with case pick and the other with very high-pallet turns to support downstream DCs.

ACTIV technology cuts expenses. lowers required building footprint, streamlines inventory and improves logistic services. Truck appointments are scheduled and dock turnaround completes in 25-30 minutes.

Retrotech, Inc. can develop the right solution for your company's supply chain or warehousing problem.



Victor, NY
800.284.6333
www.retrotech.com

CITADEL[™]

COMPUTER CORPORATION

Booth #3947

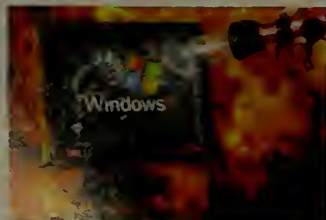
Citadel Computer Corporation is a global innovator of harsh-environment industrial computers. Taking information management beyond the desktop all the way to the shop floor, manufacturing line, freight dock or drilling rig, Citadel's rugged systems are utilized in industrial and mobile operations worldwide.

Citadel serves a variety of industries and a global customer base that includes many of the world's largest enterprises in automotive, transportation, supply chain, manufacturing and military markets.

Engineered from the ground up for easy installation and rock-solid performance, Citadel's VISTA XL[™] product family delivers a host of advanced features and benefits. Built on advanced technologies, rugged packaging and well-defined industry standards, VISTA XL[™] systems withstand environmental

extremes of physical shock, vibration, temperature and exposure.

Offering bright, high-visibility displays ranging from 10" to 18" in compact, sealed enclosures, VISTA XL[™] systems deliver advanced horsepower with convenient



touchscreen input, wireless connectivity and internal uninterruptible power. NEMA 12 / IP-66 water-proof and cold-start options are available for washdown and sub-zero applications as well as Class 1 Division 2 certifications for hazardous areas.

Milford, NH
603.672.3600
www.citadelcomputer.com

TriEnda[®]

A Wilbert Company



Booth #3403

In today's world, packaging and freight are generally the second largest cost drivers. TriEnda has a rich history of developing innovative solutions to help customers reduce these sometimes hidden costs.

TriEnda, a member of Wilbert Plastic Services, is the largest industrial thermoformers in North America and an industry leader in the material handling and packaging industry. Technologically designed and engineered, TriEnda's heavy gauge single and twin sheet thermoformed plastic products are available in five material handling categories: distribution/warehouse, self palletized returnable shipping systems, custom engineered dunnage, and manufacturing storage.



More than a quarter of a century of industry experience, TriEnda knows how and whether plastics — returnable and reusable products — are a solution for you. We listen first, diagnose second, and counsel third — offering the highest level of service, expertise, and product integrity available from one source.

TriEnda continues to pioneer new frontiers earning patents and responding to customers' material handling challenges in many industries. New products and services from one-way pallets designed to meet export regulations to RFID solutions for close loop applications are among the many solutions available from TriEnda.

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www.triendacorp.com

CATTRON[®] theimeg[™]

Booth #425

Anywhere the operator of a machine can be moved to a safer, more efficient location, **Portable Radio Remote Controls** by Cattron-Theimeg have helped prevent serious injury while increasing efficiency and productivity for many industries. With over 58 years of RF experience Cattron-Theimeg is the largest manufacturer of industrial radio remote control in the world. Applications include overhead cranes, locomotives, ship loaders, mining equipment, furnace doors and many other operations that have been made safer and more efficient by remote control operation. The company also manufactures Laser Collision Avoidance systems for cranes and overhead machinery. All products are available with a variety of available features at

many price levels backed by Cattron-Theimeg's unparalleled worldwide service and support network. Complete product details can be obtained from the company's web site or by calling for more information.



Sharpsville, PA
724.962.3571
www.cattron-theimeg.com

Booth #134

The Pallet Weasel

Lambie Entrepreneurial, Inc is a solution-oriented company located in Upstate New York. LEI is best known for their pallet strapping tool, The Pallet Weasel.



The Pallet Weasel offers customers a simple solution to the age-long dilemma of feeding strapping through pallets. The high-density polyethylene (HDPE) tool has no moving parts and fastens to any standard broom handle.

Metal or poly strapping is fed through 2 one-inch slots and held in place by friction. The broom handle is then used to quickly feed the

strapping through the pallet. This simple but effective design increases warehouse productivity while lowering injuries associated with feeding strapping by hand.

Lambie Entrepreneurial continues to push The Pallet Weasel as the most practical and economical pallet strapping solution in the material handling industry today.



Pulaski, NY
877.485.7935
www.PalletWeasel.com

EaglePicher[™]

Booth #3621

EaglePicher offers advanced power solutions for defense, space, industrial and commercial applications.

EaglePicher Horizon[™] batteries are ideal for lift trucks because they're optimized to fast charge in 1/8 the time of a conventional battery without removal from your lift truck. You'll extend lift truck in-service time, save time and effort, improve safety and eliminate the expense of extra batteries and a battery changing room.



aren't always reliable. By replacing these batteries with a single EaglePicher Horizon battery, you can reduce battery weight by up to 200 pounds, improving fuel efficiency and increasing load capacity. Plus maintenance-free EaglePicher Horizon

batteries can really crank—up to 210 times in a row in a recent start test.

Featuring patented woven-grid technology, EaglePicher Horizon batteries deliver more power per pound than any other lead acid batteries.

Starting power for your trucking fleet can be a weighty problem, too. To get the energy you need, it takes four heavy, maintenance-intensive Group 31 batteries that

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TRIO PINES[®] TrioPines[®] CASTER

Booth #109

Manufacturing for 25 years, Trio Pines Casters has created a reputation for providing high-quality casters and wheels at competitive prices. Offering a wide array of off-the-shelf products for thousands of applications worldwide, Trio Pines also produces custom and specially-designed casters for everything from foodservice and medical equipment to heavy-duty casters and wheels for factories and industrial plants.

The Trio Pines ability to offer so many products at aggressive prices has allowed the company to grow and become one of the major caster companies in the material handling industry.

With a new facility in La Mirada, California (near Los Angeles), Trio Pines also operates two fully-stocked warehouses in Chicago and Dallas, with sales offices and distributorships nationwide.

At ProMat 2005, Trio Pines will be showcasing stainless steel casters, institutional total-lock casters, new WorkStation casters, and "flavored" wheels — polyurethane treads in designer colors.



With its new product development, and special cost savings for customers, Trio Pines Casters continues its commitment of providing the best value in the material handling industry.

La Mirada, CA
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AGVS

Automatic Guided Vehicle Systems

The AGVS Product Section of the Material Handling Industry of America (MHIA) recently finalized a video showing how AGV technology is used to reduce costs and improve productivity in various applications.

Automatic Guided Vehicles are driverless vehicles that are used to

microelectronics, plastics and primary metals. Companies that can benefit from this technology include both Fortune 500 companies as well as small manufacturing companies.

This technology has matured significantly and is a viable, safe, cost-effective way to transport raw materials, finished goods and even people.

Be sure to visit many of the AGV suppliers who will be exhibiting at ProMat 2005. To

find an AGV supplier or to request a copy of the DVD please contact MHIA at (800) 345-1815 or via email at agvs@mhia.org.

800.345.1815

www.agvsolutions.com

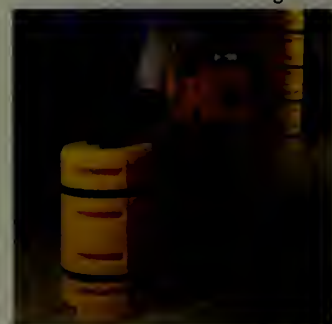
S

SENTRY

PROTECTION PRODUCTS

Sentry Protection Products is an innovative company dedicated to creating unique ways to protect building assets in industry. Sentry's products include Column Sentry®, Rack Sentry®, and Concrete Wrap™.

Column Sentry® is a patented method to protect building columns from forklift collision damage. It's



lightweight, easily installed, and highly visible. Column Sentry® is a polyethylene structure designed to surround columns with a cushion of air, pre-

venting costly damage to the column, damage to forklifts, and injury to forklift operators. It is available in sizes to fit most building columns.

Rack Sentry® uses Sentry's patented air-chamber system to add shock-absorbing protection to pallet rack uprights. Rack Sentry® is manufactured of EVA plastic, giving this bright yellow device the ability to absorb the bumps and hits normally leading to rack damage and possibly failure. Rack Sentry is installed in seconds without attaching to the floor and is available to fit most rack uprights.

Other products in Sentry's lineup include Concrete Wrap™, a padding added to existing concrete columns and posts, and Corner Sentry™, a unique shock-absorbing guard for wall corners.

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www.sentrypro.com

Booth #4727

SICK

Booth #1014

Logistics operations count on SICK for innovative technology that delivers results to their bottom line.

Like retrofitting outdated conveyors with **ZoneControl™** – an electronic conveyor control solution that costs a fraction of the price of a new conveyor and can increase throughput by 100%.

Eliminate side-by-sides on conveyors and ensure only the proper

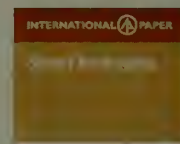
number of packages are shipped with the **Flat Surface Recognition (FSR)** system, saving time and money.

Optimize parcel handling with an integrated **automatic identification and dimensioning** system that uses volume measurement to verify package dimensions and vision on laser-based scanning for package identification, improving revenue recovery.

Improve productivity levels and realize complete factory automation with the **CLV family of Bar Code Scanners**. These high performance scanners are ideal for applications where high throughput is needed.

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International Paper Smart Packaging provides products and professional services that improve business processes using RFID enabled technology. Our customer-focused services deliver integrated solutions that meet your business needs from business case development to implementation. Our products help you solve business problems no matter where you are in the supply chain – from manufacturing to the retail shelf. We give you access to the proven thinking behind the technology, based on real world experience...not theory.

Our experience is a result of successful pilots and other client implementations, including the first-of-its-kind warehouse tracking system implemented at our Texarkana mill warehouse. We deliver results with RFID, because we work

with leading RFID hardware and software vendors, at our Customer Solutions Center, where rigorous testing addresses the diverse challenges faced when using the technology in a harsh warehouse environment.

THINKING



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economic and industry market trends for manufacturing management to keep pace with today's technology to improve their competitive posture. Topics of some of the exciting cover stories you will be able to read in the coming months are:

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- Wireless Technology
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LOFTWARE, INC.

 Global Marking Solutions for Enterprise Applications[™]

Booth #3852

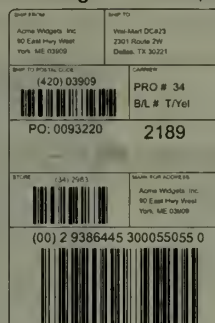
For over 18 years, Loftware has been providing advanced barcode and label printing technologies, including RFID, for leading manufacturers and distributors across a broad range of industries, including automotive, retail, logistics, and healthcare/pharmaceutical. Loftware's global marking solutions are hardware and printer independent, and extremely robust, within high-demand environments. Loftware provides both server and client side technology allowing mission critical applications to meet the barcode compliance needs within the global supply chain.

Loftware's flagship product, the **Loftware Print Server**, is a server based software solution for managing and processing label and RFID requests from corporate applications. This enterprise-

class solution is a highly scalable and fault tolerant system that is designed to handle thousands of requests targeted to hundreds (or thousands) of printers. In addition, Loftware's **Premier Plus RFID**

solution allows for EPC compliance marking and labeling. The Loftware RFID solution allows users the capability of creating and producing EPC compliant **RFID Smart Labels**. Leverage the investment of your current ERP, WMS or MSCA, the Loftware technology easily integrates with your current database applications, while providing a seamless method for RFID compliance mandates. This solution will support any combination of barcode and RFID devices.

York, ME
207.363.3195
www.Loftware.com



IAC industries

Booth #1466

IAC Industries answers the perpetual question, "Where do I put all this stuff?" with the new **Workmaster[™]** Storage Cabinet Workbenches. These units offer wide, large capacity drawer pedestals supporting a variety of worksurface options that include laminates, maple block and stainless steel. Company President, Don Murphy explains, "The main feature of this bench is the extra storage that the cabinets give the customer. It's rugged, sturdy and with the use of optional accessories can become an entire work-center with added capacity."

Also on display at this year's ProMat show will be the company's versatile Dimension 4 Workstation and super-functional Packaging Stations, among other popular IAC products.

Based in Brea, California, IAC industries is a prominent manufac-

turer of technical furniture (production workbenches, workstations, and related products) for companies performing assembly, testing, repairs, inspection and related applications across a wide spectrum of industries. IAC products are 100% made in the USA and sold worldwide.



IAC Industries currently offers the widest range of workstations, workbenches, seating, and workstation-related accessories available from a single manufacturer.

Brea, CA
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HAWKER

Booth #1828

Hawker is the world's largest brand of lead-acid batteries for industrial electric vehicles and offers cutting edge solutions for controlling and reducing motive power operating costs.

Hawker offers six different battery product lines including:

- **Energy-Plus** – providing up to 25% more energy than conventional batteries, by utilizing a unique multi-plate design. More power means longer run times, fewer battery changes and fewer batteries!



- **Water Less** – requiring watering just 4-6 times per year. Less watering means significantly reduced maintenance expenses.

Only Hawker offers high frequency smart chargers, the most productive and electrically efficient chargers available.

- **Patented LifePlus** technology lowers utility costs, extends watering intervals and extends battery life, while automatically charging batteries of three different voltages from 250 to 1200 AH.
- **PowerTech** packages LifePlus technology in a single voltage configuration, managing batteries from 450 to 1200 AH without adjustments.

Hawker specializes in tailoring solutions that meet users' unique needs. Visit Booth # 1828 at ProMat and see how Hawker can configure a solution to meet your needs.

Ooltewah, TN
877.7HAWKER
www.hawkerpowersource.com

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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The High Cost Of Corruption

THE COST OF REGULATION is high, but the cost of corruption may be higher. Nov. 15 marked the implementation deadline for a key section of the Sarbanes-Oxley Act for companies with fiscal years ending on or after that date. Under Section 404 of the law, publicly traded companies must have new financial monitoring controls in place, certified by auditors. Many chief executives are complaining loudly that implementing "Sox" is costing their companies heavily in time and money. But we should all be indignant at the broader economic "tax" imposed by corporate corruption on America.

Corruption makes markets less efficient, more costly, and less innovative. Take the latest insurance scandal unearthed by New York State Attorney General Eliot Spitzer. Bid-rigging and secret payoffs among insurance brokers have undermined much of the competition in the insurance market. Instead of analyzing different policies and bringing the best and cheapest to their clients, major brokers gave the business to those who paid them off.

Think about this for a moment. We now know that Corporate America is paying far more than it should for property and casualty insurance. We have just learned that both companies and employees are paying more than they should for disability, life, and other insurance in the employee benefits market. The next uproar may well be in

Rigged markets, as well as regulation, can hurt growth

medical insurance, which has been in a crisis for years. Doctors find it increasingly impossible to pay high premiums and are dropping out of the profession. Expensive medical malpractice lawsuits are partly to blame. But is this crisis due to rigged markets for medical insurance as well?

The truth is economists don't usually compute the tax that is imposed on economic growth by corruption. They should. In the past few years, we have witnessed conflicts of interest and manipulation within the initial public offering, mutual-fund, investment banking, and insurance markets. These rigged markets stifle innovation, erode discipline in the markets, channel money into less productive activities, add expense, and undermine national competitiveness.

We know that government regulation places a heavy burden on America's companies. We should recognize that market corruption may place an even heavier burden on the nation's economic growth.

The Greatest Gifts of All

AT \$65 BILLION AND counting, the Top 50 donors in *BusinessWeek's* annual ranking of America's leading philanthropists have already given an enormous amount of their money to charity over the course of their lifetimes. This year many supersized their donations. Even more important, younger donors are changing the way they give, transforming the model of philanthropy (page 86). And corporations, too, are seeing philanthropy in a new light—as a means to boost employee health, morale, and loyalty at a time of rising hostility overseas.

First, the mega-givers. Warren E. Buffett's late wife, Susie, left \$2.5 billion to the Omaha-based foundation she shared with her husband, and Bill and Melinda Gates gave an estimated \$3 billion to their foundation—one of the largest gifts in history by living donors. Liquor importer Sidney E.

Frank gave Brown University, from which he dropped out because he couldn't afford the tuition, its largest gift ever—\$100 million to fund scholarships for 130 students a year. Related Cos. Chief Executive Stephen M. Ross pledged \$100 million to the University of Michigan Business School, the largest gift in the university's history.

EBay Inc.'s founder and chairman, Pierre Omidyar, went beyond the numbers game by creating an entirely new model for giving. Using a bottom-up approach, much like eBay's online marketplace does itself, Omidyar Network funnels small grants to people who use the Web to ask for help for specific projects. Most of the money goes to nonprofit organizations. The rest goes to for-profit companies. Omidyar is also using the Internet to allow ordinary people of modest means to donate money directly to projects around the world.

Global philanthropy grew in importance for corporations this year. With corporate operations, revenues, and profits all growing in Asia and other parts of the world, companies are shifting a larger share of their philanthropy abroad. It's a form of social insurance. IBM, for example, boosted its global contributions to 30.4% from 12.4% in 2000.

Unfortunately, those individuals who came into wealth in the 1990s still donate little of it. On average the nation's richest 1% own 41% of the country's wealth, yet donate only 2% of their incomes each year to charity. More needs to be done. This year's top donors are showing the way.



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BusinessWeek

BER 6, 2004

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The three
scariest words
in U.S. industry:

"The China Price"

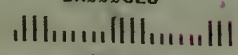
Special Report

Cut your price at least 30% or lose your customers. Nearly every manufacturer is vulnerable. The result: A massive shift in economic power is under way.

Plus: Rethinking the free-trade model

BY PETER DRAGANO, DEXTER ROBERTS, AND AMY SCHLESINGER (P.102)

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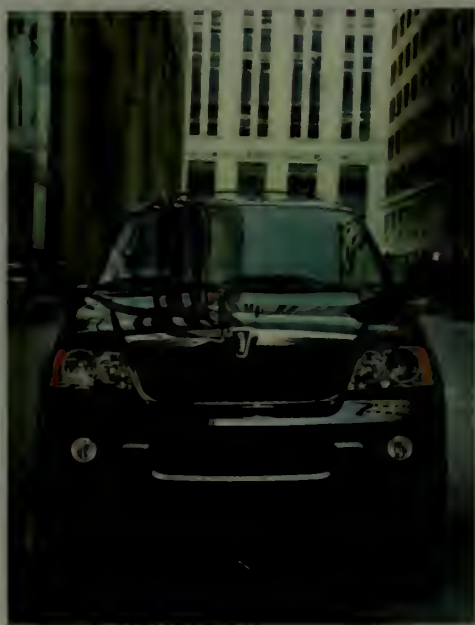


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LIBRARY

WHAT GIVES? ROBOTS CAN DRIVE AROUND MARS BUT NOT ON EARTH





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ONSLAUGHT

Even manufacturers that weathered past import waves are being swamped by China's combo of low prices and high tech

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They're the three scariest words in U.S. industry. What they mean is, cut your price at least 30% or kiss your customers goodbye. And what's different now is that nearly every manufacturer is vulnerable—from furniture to high-end networking gear. The result: A massive shift in economic power is under way.

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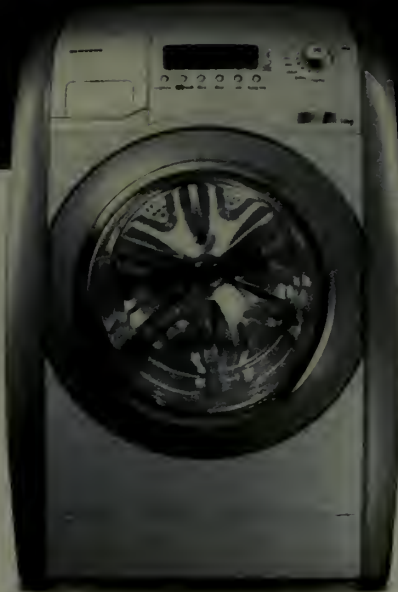
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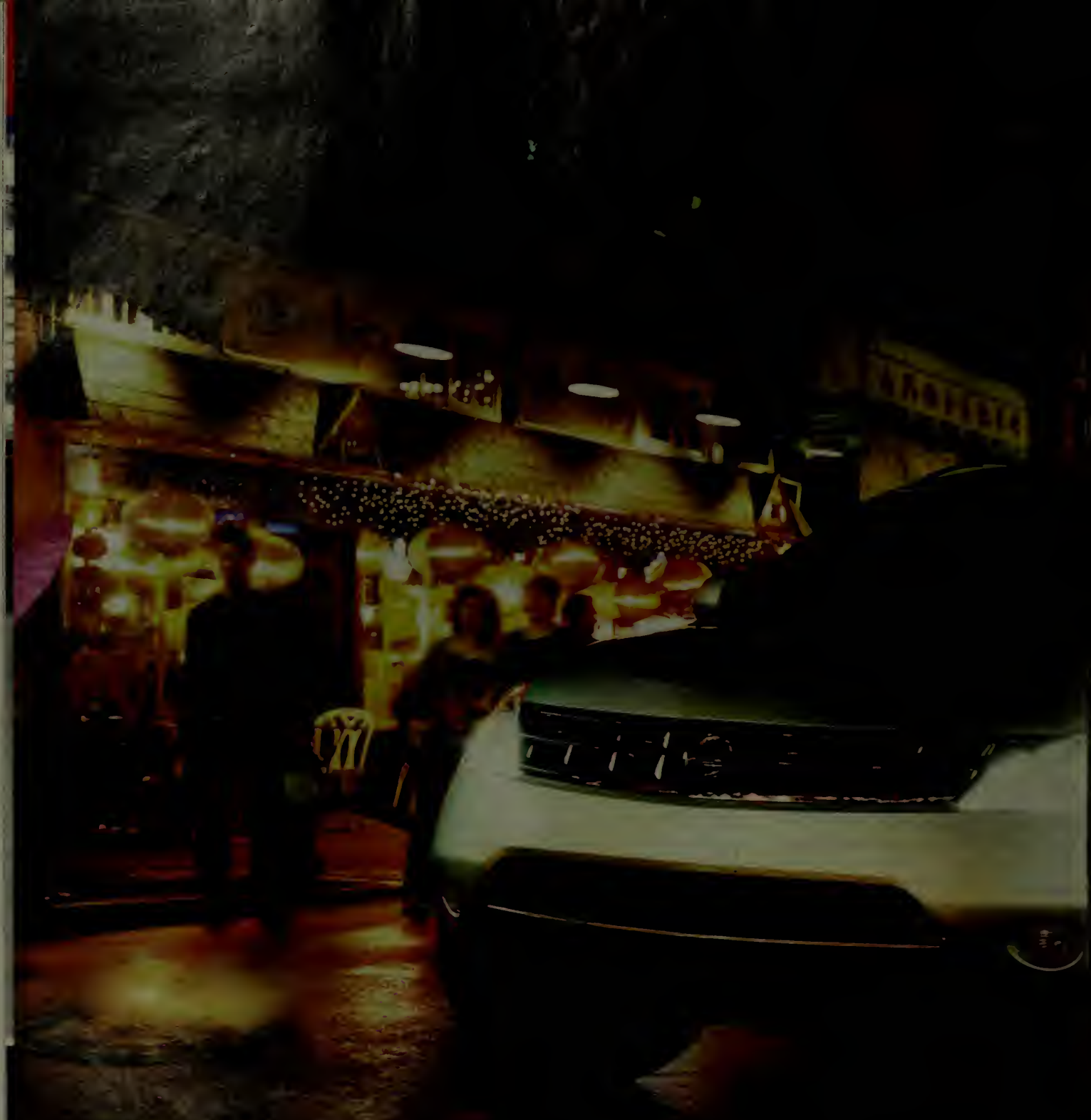
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Special Report: Retail's Little Guys Come Back

Who's afraid of Wal-Mart? As holiday shopping revs up, specialty retailers and chains with unique lines thrive by offering what the big-box stores can't. Plus: The sales outlook, and custom goods on the Web



The Age of the Dividend?

With President Bush's reelection, the Republican sweep of Capitol Hill, and swollen corporate coffers, Standard & Poor's believes companies will reward shareholders with larger and more numerous payouts

Technology Special Report: TV, Today and Tomorrow

Digital technologies mean far more than just sharper picture quality. They'll bring a whole new world of capability and convenience. Plus: An HDTV shopper's guide, a slide show, and more

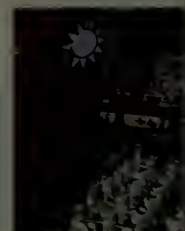


'Tis the Season for Online Tools

The holidays are crucial for sales—for some they will make or break the entire year. Small businesses can boost their take by jazzing up their Web site, adding a blog, and making careful use of things like paid search advertising

Taiwan: Profit and Peril In China's Pull

For how long can the island steer its own path, despite growing economic dependence on its neighbor and testy relations with Beijing?



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»»TOOLS

Your Portfolio, Stock Screener, MBA Search, and Mutual Fund Scoreboards

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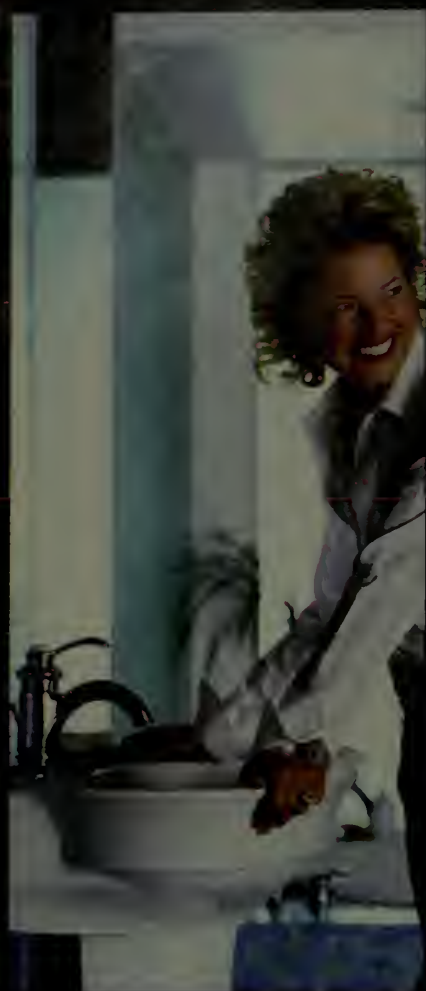
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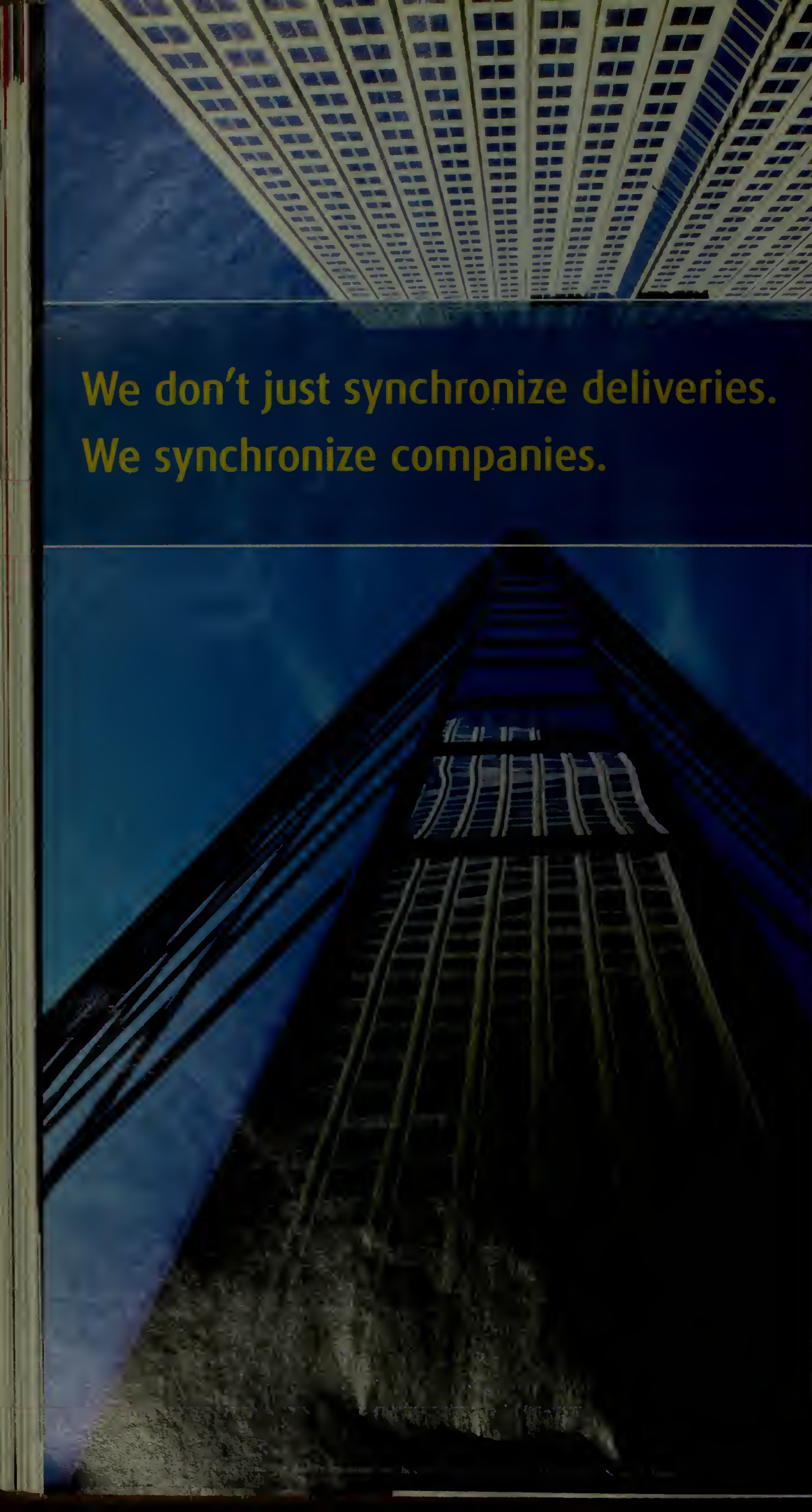
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EBEL

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JP Front

"I don't think it's a failure. It's a success."

—Donald Trump, on Trump Hotels & Casino Resorts' bankruptcy filing, to the Associated Press

EDITED BY IRA SAGER

HOT BONDS RUSSIA MAKES INVESTMENT GRADE

JUST SIX YEARS after Russia defaulted on \$40 billion in domestic debt, Russian bonds are again a hot property. On Nov. 18, **Fitch** ratings upped its long-term rating for Russian government bonds by one notch, to **BB-**. That came little more than a year after **Moody's Investors Service** also raised Russia's bonds to investment grade.

It's no secret why. Oil and gas account for 55% of Russia's exports—and with oil prices around \$50 a barrel, the country is raking in petrodollars as never before. Moscow's

foreign currency reserves now total \$113 billion—nine times their level at the end of 1999, and a comfortable cushion against any new crisis. Finance Minister **Alexei Kudrin** has used the oil and gas windfall to reduce Russia's external debt, get government expenditures in hand, and fashion a functioning tax system.

Not all of the news from Russia is favorable, however. Structural issues such as banking reform and deregulation may help explain why the third major rating agency, **Standard & Poor's**, hasn't yet raised Russian bonds to investment grade. But the financial

situation is so solid that analysts are convinced an S&P upgrade is just months away.

—Jason Bush



OIL JACKPOT
55% of exports
derive from fuel



RETAIL DETAIL

The Bad-News Bar Code

REMEMBER THE Y2K BUG? That was the big switch in computer code at the millennium that some warned would bring many of the world's computer systems crashing down. It didn't happen. Now comes talk of a mini-Y2K that could screw things up for retailers and their customers.

On Jan. 1, all retailers using bar-code scanners in the U.S. and Canada must switch to new 13-digit bar codes, up from 12 digits. This will bring them in line with the Europeans. Many retailers have modified their scanners, but analysts believe some smaller ones have not done so.

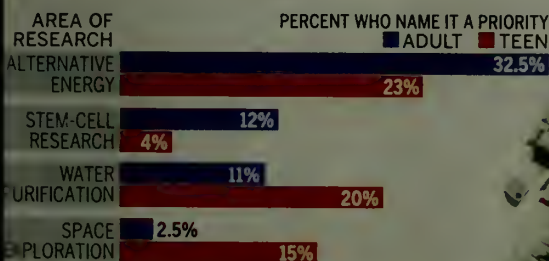
What could really tie the industry in knots, however, is that many retailers—even some biggies—haven't rewritten the software they use for tracking sales, orders, and inventories. **AMR Research** expects 10% to 20% of retailers will have problems with scanners or software. "It could cause some major disruptions," says Ray Tromba, a director of retail services at **IBM**.

The topic is not one retailers are eager to discuss as they roll into the holidays. Calls to major retailers, including **CVS** and **Kroger**, didn't yield interviews. So attention, post-holiday shoppers: You might want to set aside some extra time to allow for technical difficulties.

—Steve Hamm

THE BIG PICTURE

GENERATION GAP Both teens and adults (33% of each) name anti-terrorist technology the top government research priority. Others include:



data: Lemelson-MIT Invention Index



AD NAUSEAM

ONE MORE WAY TO DUCK MAD AVE

IT'S THE LATEST scheme by advertisers to get their messages across in the age of TiVo. But long before the expected rollout of new ads next spring, tech-savvy couch potatoes already have a way to zap them.

The new TiVo idea, disclosed in mid-November, is to program tags onto advertisements that are played on TiVo's personal video recorders. Say a user is



watching a recorded episode of *The West Wing*. As she fast-forwards through a car ad, a picture of a new SUV appears on the screen, along with an invitation to click for a chance to win the car in a sweepstakes. Those who click get an extended 60-to-90-second ad designed just for TiVo. If enough viewers can be enticed this way, it could boost ad sales for TiVo while easing advertisers' fears that growing numbers of viewers will skip over their messages.

Only one problem: Legions of tech-savvy TiVo users know how to program their service to skip over ads 30 seconds at a time. The one-time secret, now widely available on the Web, involves hitting the following sequence on the remote while watching a recorded program: Select, Play, Select, 30, Select. The TiVo dings twice, acknowledging the change, and users no longer fast-forward through ads; they leap over them in 30-second jumps. A TiVo spokesperson says there are no plans to block this hack. "It's a backdoor thing that people do," she says. For frustrated advertisers, the hunt continues. —Stephen Baker

HALL OF SHAME DIVA-BEHIND-BARS SHIRTS, GOING CHEAP

PEOPLE ARE beginning to forget about Martha Stewart, who started serving her five-month sentence at Alderson Prison in West Virginia in October. That, at least, is the conclusion drawn by Shay Roberts at TheMarthaPrisonGiftShop.com. The site sells "Martha-in-jail"



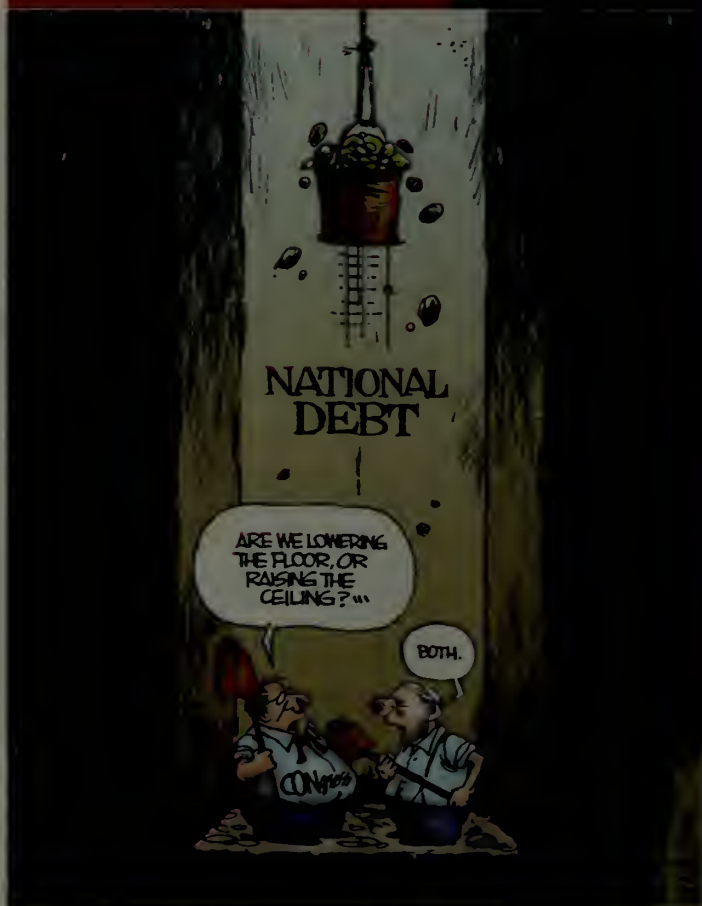
theme goodies such as T-shirts and caps. Its best-seller: An apron that reads "Alderson Federal Prison: Protecting you from homemakers."

While the site enjoyed lively sales when the domestic diva first entered the slammer, the action has cooled. "People are used to the idea [of Stewart being behind bars]," says Roberts. He's hopeful that interest will pick up when Stewart reenters civilian life in March. —Olga Kharif

TIE TALES

ZIP THIS Just how lazy and inept can men be? Casual Male, the big-and-tall chain, has sold about 100,000 "zipper ties" in the past year. The "Zipper," a pre-knotted tie that slips over the head, gets tightened by way of a zipper on the back. Zipper ties have been mainly a \$10 novelty item. But Casual Male gets up to \$25 a tie. TV talk-show host Tony Danza gushed over the tie and ESPN2 host Jay Crawford raved that it has "changed his life." Says Casual Male CEO David Levin: "A lot of men see it as a timesaver or seldom wear a tie and never learned how to tie it properly." As neither Danza nor Crawford are big-and-tall customers, will mainstream haberdashers follow suit? —David Kile

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FACE TIME

CHRIS MCGURK



THE HIGH ROAD TO BOFFO

Chris McGurk isn't your typical Hollywood mogul. The MGM Studios vice-chairman has a track record of green-lighting movies heavy on social import but light on blockbuster appeal. Just check out his credits: *No Man's Land* (about the war in Bosnia), *Osama* (about the oppression of women by the Taliban), and *Bowling for Columbine* (Michael Moore's documentary on guns).

McGurk, 47, is at it again. On Dec. 22, MGM's United Artists will release *Hotel Rwanda*. Made for \$16 million, the movie recounts the slaughter of 1 million people in clashes between Hutus and Tutsis; it's the true story of Paul Rusesabagina (played by Don Cheadle), a hotel manager who over 100 days uses his cunning to save the lives of 1,200 people while the U.N. and others failed to intervene. "The Rwandan genocide has a lot of parallels today in terms of questions about intervention," says McGurk. Spoken like a man determined to break out of the holiday movie clutter.

—Tom Lowry

TELECOM TALES

HOW 4G CRANKS UP THE SPEED

MAMORU SAWAHASHI has been driving in circles for 16 months, but he still feels he's making headway. Sawahashi is working on hyperfast fourth-generation (4G) cellular service for Japanese carrier NTT DoCoMo. Since July, 2003, his team has driven an Isuzu van in a half-mile loop around the verdant Miura Peninsula south of Tokyo 250 times a week to test reception from a nearby antenna. "There are many problems to be solved, but we have made a lot of progress," says Sawahashi.

That's right: 4G. Sure, most of the world has yet to adopt 3G, but in Japan millions use 3G every day to make videophone calls, download clips of soccer games, check traffic, and send animated e-mails to friends. So DoCoMo is looking ahead, and this year

it plans to devote \$91 million to 4G research. Inside the white van, traveling at up to 25 mph, Sawahashi's team has managed transmission speeds up to 300 megabits per second—20 times as fast as the speediest 3G links and about 150 times faster than most wired broadband connections to U.S. homes.

Make no mistake: 4G isn't ready for prime time. The signal degrades when the van gets more than a half-mile from the base station. And forget about putting a 4G phone in your pocket. The receiver is the size of a refrigerator and consumes as much power. DoCoMo doesn't expect to launch 4G before 2010.

Skeptics wonder if anyone will ever need that much mobile bandwidth. And



technologies such as Wi-Fi and Wi-Max will probably be acceptable, cheaper alternatives for many uses—even if not so fast. But DoCoMo is confident that if it builds it, applications will come. Once those services arrive and subscribers clog the airwaves using them, fear not: DoCoMo is already working on 5G and 6G. —David Rock

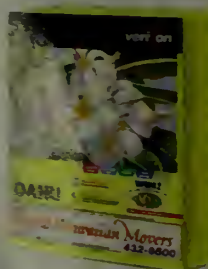
ART OF THE DEAL HIDDEN TELCO TREASURE IN HAWAII?

CARLYLE GROUP is betting on a neglected corner of telecom—the phone book. The Washington (D.C.) private equity firm has bought the Hawaiian operations of Verizon for \$1.7 billion—only \$2,300 per line. But the jewel, says Managing Director James Attwood Jr., is Verizon Hawaii's Yellow Pages. Why

does Carlyle see gold in the Yellow Pages? Attwood aims to expand online, where he expects dramatic ad growth.

That strategy has worked before. Carlyle bought Qwest Communications' directory biz for \$7.5 billion in 2002. In July, Carlyle took part of it public as Dex Media, netting investors a return of 250%, says Attwood. He expects similar results in Hawaii. "The market has come to appreciate the stability [and] high-cash-flow nature of the Yellow Pages," he says. So has Carlyle.

—Alex Salkever



THE STAT

1.5

The number of days a U.S. chief executive officer had to work in 2003 to earn the equivalent of a typical employee's yearly salary.

Data: Bureau of Economic Analysis

STATUS WITHOUT THE QUO



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As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

The Web for The People

AS THE WORLD WIDE WEB caught fire in the mid-1990s, a long-haired programmer named Pierre M. Omidyar fretted that big businesses would take over. "I wanted to give the power of the market back to individuals," he said. So he spent Labor Day weekend in 1995 furiously coding a bare-bones site he

called Auction Web. Omidyar, still working full-time at onetime Silicon Valley star General Magic, sought to create a perfect online market—one that would let real folks compete on a level playing field with the big boys.

Did it ever. Today, eBay Inc., as it's now known, has catapulted from its early days as the place to trade Beanie Babies to become the Web's most powerful corporate enterprise in its own right, worth more than \$70 billion. So far this year, more than a billion items have been listed for sale on eBay, from antique doilies to 2005 Hummers. Were eBay a country, its expected gross sales of \$34 billion this year would rank as the 59th largest gross domestic product in the world, just behind Kuwait. "It is an economy of its own," says economist W. Brian Arthur of the Santa Fe Institute.

That's largely thanks to Omidyar's original insight: The Web's real power lies in its ability to connect people instantly around the world, so buyers and sellers alike can share near-perfect information about prices, products, and each other. By putting in place a few key rules, such as a feedback system in which buyers and sellers rate each other, Omidyar sparked a vibrant community that numbers 125 million members worldwide. To a remarkable degree, those millions govern themselves. It was they, not eBay managers, who decided to start selling cars and car parts several years ago. That's now a \$10 billion-plus business. "The best ideas and the best feedback come from our community of users," says eBay

eBay's founder crafted an online market where participants set the rules



OMIDYAR IN 1998

Chief Executive Officer Margaret C. Whitman.

The eBay Way is starting to turn traditional commerce on its head. Not content to be mere "consumers," people online are recognizing they have unprecedented power, such as determining for themselves the prices they want to pay. Other enterprises are tapping into that power as well—sometimes with Omidyar's help. Among his investments are the community site Meetup Inc. and Linden Lab, creator of Second Life, a virtual online world literally created by the players themselves. Says Meetup co-founder and CEO Scott Heiferman: "Pierre's the smartest guy in the world in understanding what happens when you give people the power to help themselves." Now, even traditional corporations such as Procter & Gamble Co. are starting to use that bottom-up dynamic, enlisting thousands of online customers in marketing campaigns.

eBay's phenomenal success would be more than enough to hang a career on, but Omidyar, 37, has only begun. Still eBay's chairman, he spends most of his time on Omidyar Network LLC, the philanthropic organization he and his wife Pamela, established in 1998 to fund groups that empower people in new ways. Last March he announced an unheard-of move: The group will forgo millions of dollars in federal tax breaks to invest in companies as well as nonprofit groups. No one should be surprised that Omidyar is far from finished shaking things up. ■

—By Robert D. Ho



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“The Democrats took their eye off the ball decades ago: They haven’t taken the right wing seriously”

—Carol Georgopoulos
 Albuquerque

WEIGHING IN ON THE NEXT FOUR YEARS

YOUR CHARACTERIZATION of George W. Bush’s victory as a “clear mandate” and a “convincing victory” smacks of revisionist history (“The next four years,” Special Report, Nov. 15). With a 3% margin of victory and 130,000 popular votes in one state making the difference, his win is anything but clear or convincing. Our country is still very divided, and Bush must acknowledge that almost half the country voted to send him back to Texas. If he wants to focus on his legacy for the history books, he needs to set an agenda that reflects the common goals of a majority of Americans.

I rely on *BusinessWeek* for unbiased business reporting, not to push a biased agenda not reflected in the facts.

—Michael Ferrante
 Cranbury, N.J.

FRANKLY, ALL THE ADVICE and cheer-leading you offered Senator Kerry during the campaign did not do a bit of good (“A second-term agenda for President Bush—and America,” Editorials, Nov. 15). Maybe you guys should quit dispensing uninformed political advice and stick with your

core competency: reporting business news. In case you missed it, the electorate just said “no” to media elitism and vote for action—not navel-gazing critics.

—Randall D. Loflan
 Midlothian, Va.

HEAVEN HELP those of us in the middle

—Gregory Ric
 Williamston, Mich.

AMERICA’S RECORD-HIGH federal deficits are funded for the most part by foreign governments and investors. The day of reckoning is not far off, when these same foreigners demand much higher interest rates as their currency losses continue to mount in the face of a collapsing dollar which continues to hit new lows against the euro. Just as in 1989, foreigners will control the destiny of America and will insist that taxes be raised and federal expenditures be slashed to bring America’s fiscal house in order. When that happens, you can say goodbye to federal pork-barrel spending and the phony prosperity in the red states. The collapse will be along the lines of what befell California in 1991-95, when the Cold War ended and defense budgets were slashed. After the creditors were un-

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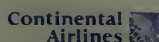
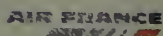
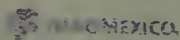
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Readers Report

CORRECTIONS & CLARIFICATIONS

In the Dec. 6 table of contents entry for "America's top philanthropists" (Cover Story), the correct figure for Bill and Melinda Gates' Microsoft Corp. dividend donated to their foundation should be an estimated \$3 billion, not \$3.35 billion.

"The online ad surge" (Web Smart Special Report, Nov. 22), should have credited ad agency Ted Bates & Co., and not its eponymous founder, for the 1980s push toward cable-TV advertising.

The review of *On Intelligence: How a New Understanding of the Brain Will Lead to the Creation of Truly Intelligent Machines* ("Redefining smart," Books, Nov. 8) confused the book's author, Jeff Hawkins, founder of Palm and Handspring, with Trip Hawkins, game developer and co-founder of Electronic Arts and founder of 3DO.

willing to lend more money, the state of California was reduced to issuing IOUs.

—Geoffrey Lenart
Ventura, Calif.

OLD-SCHOOL LIBERALISM has by and large ignored the political center and adopted a more and more radical line, a line pushing everything to an extreme of shrill rhetoric that in a way limits debate and freedom of speech ("The world has changed: Why can't the Dems?" Special Report, Nov. 15). Blue-collar workers do not identify with this radical shift in core values represented in Senator John Kerry. Good job on the commentary.

I find it interesting that the European Union is more in line with the old-school liberalism than the American voter ("And Europe thinks the U.S. is a mess?" International Business, Nov. 15). One might think Senator Kerry was running for President of the European Union.

—Steven Woods
Pascoag, R.I.

THE WORLD HAS changed: Why can't the Dems?" is slightly off-point. Kerry was my idea of a dream candidate: Presidential, principled, thoughtful. What went wrong was that the Dems took their eye off the ball decades ago: They haven't taken the right wing seriously. Meanwhile the right wing has built up a tremendous organization of the faithful, politically and literally. This is why there aren't enough Democrats to carry an election.

—Carol Georgopoulos
Albuquerque

I AM CONCERNED that the recent election—including the barrage of 30-second TV ads and one-liners—reduced truly important issues to overly simplistic slogans ("A time for realism and reaching out," Special Report, Nov. 15). I retain the sincere belief and hope that America's true values and ideals can resurface and that we can deal in a constructive, effective way with real issues. Doing so will take serious leadership, rather than the tenor of arrogance and talk of "mandate" and "political capital" that characterized the first few days after the election.

—Dennis J. Crane
Covington, Ky.

PUBLIC UNIVERSITIES AND THE RACE FOR MONEY

WILLIAM C. SYMONDS' "Should public universities behave like private colleges?" (Social Issues, Nov. 15) misses the point when he says public universities are "ducking a key social role" regarding access to higher education. It is no secret that there has been a widening economic gap between rich and poor students who attend college. Through AccessUVA, the University of Virginia is committing \$16.44 million of institutional funds each year for need-based grants for undergraduates. For our most needy students, there are loan-free packages. For the less needy, there is a cap on need-based loans at one-quarter the cost of four years of education. And for all students, there are packages that meet 100% of their need. Also, AccessUVA caps eligible out-of-state students' need-based loans at an in-state level and provides grants for the remainder.

—Carol Wood
University Relations
University of Virginia
Charlottesville

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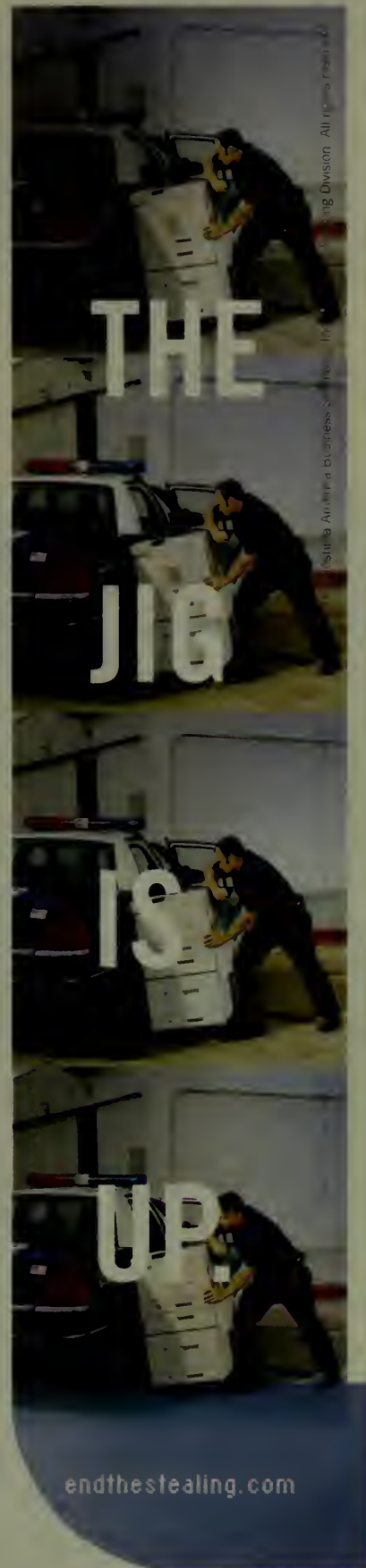
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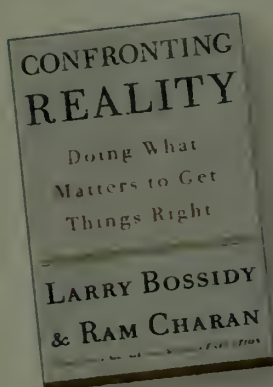
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Books

Comic Geniuses

MEN OF TOMORROW Geeks, Gangsters, and the Birth of the Comic Book
By Gerard Jones; Basic Books; 384pp; \$26

Those who have followed the march of electronic-media culture will find striking parallels between the current Internet Age and the pre-World War II era described by Gerard Jones in *Men of Tomorrow: Geeks, Gangsters and the Birth of the Comic Book*. Both periods saw explosive

growth in the information and entertainment industries. And both depended hugely upon technology—low-cost computing today vs. low-cost printing then.

Jones, who is on the advisory board of the Media Studies Program at Massachusetts Institute of Technology and a former comic book writer himself, brings an insider's point of view to this nonfiction account of the same period evoked in Michael Chabon's Pulitzer Prize-winning novel, *The Amazing Adventures of Kavalier & Clay*. Jones provides a lively portrait of the talent, energy, and chutzpah that gave birth to the comic book industry. And the story bears a curious resemblance to accounts of tech startups or college kids cutting class to become dot-commers. The accents are different, but the spectacle is the same—and uniquely American.

Men of Tomorrow adopts the structure of alternating chapters to tell two interconnected stories. It describes the careers of Harry Donenfeld and Jack Liebowitz, the fast-talking salesman and the closemouthed number-cruncher who built the company that would become DC Comics. Interspersed are the stories of Jerry Siegel and Joe Shuster, the geekish creators of Superman who sold the rights to Donenfeld and spent all their lives trying to get them back. How did Donenfeld—who cared little about kids, or even about publishing or entertainment—become a founder and publisher at a company that, Jones argues, would become the template for modern media organizations?



The mere mortals behind the DC Comics craze

on the newsstands, and new titles were constantly springing up. It was a business for someone with street smarts—a business made for Harry Donenfeld. His Donny Press started out as a printer of cheesy magazines. But seeing that an investor could make “a fortune on the smallest investment,” Donenfeld turned to publishing his own pulpy knockoffs, such as *Juicy Tales* and *Hot Tales*.

Later, an old client asked Donenfeld for a job for his son, Jack Liebowitz. A former socialist and union organizer, Liebowitz signed on with Donny Press as the business manager, and his financial savvy and brilliance kept the

The short answer is nerve, but there's much more to the story. Swept along with the wave of Jewish immigrants around 1900, the Donenfelds landed on Manhattan's Lower East Side, a neighborhood with “half a million people in a square mile.” Surveying the new world, the immigrants' children realized that “they were not living for today but for tomorrow” and that to enter that world of tomorrow “they would have to become entirely new beings.”

The 1920s were a time of explosive growth in magazine publishing. There were more than 2,090 magazines

business afloat while many others went under. After his distributor failed, Donenfeld bought it, vertically integrating the business of content, production, and distribution under the name of Independent News.

Meanwhile, juggling the story of Siegel and Shuster, Jones gives us a flavor of early geek culture. Siegel was crazy about adventure movies, especially "Zorro and all those secret heroes who masqueraded as mild-mannered citizens." He and his school chum, Shuster, began composing illustrated stories and trying to sell them. Then, when he saw one of the first comic book titles, Siegel had his "Eureka!" moment: "We can do this!" He even had an idea for a character: Superman.

Siegel and Shuster submitted some material to comic book publisher Major Malcolm Wheeler-Nicholson, a bizarre figure given to wearing a French officer's cloak and a beaver cap. They also sent the first 13 pages of what would become Superman. Their material ended up in the slush pile.

After Wheeler-Nicholson went bankrupt, Donenfeld and Liebowitz snapped up his properties. Deciding they needed another comic, an editor slapped together *Action Comics*. That included Superman, which was fished out of the heap. This Superman was cruder than the one we're used to: Instead of flying, he jumped. But the basic elements were there: the destroyed planet, the survivor, the powers, the secret identity, and Lois Lane. Siegel and Shuster got a \$130 check; rubber-stamped on the back was a note saying that, in cashing it, they were signing over all rights. It was the summer of 1938, and Superman was a nobody. By mid-1939, he had spawned an industry.

Men of Tomorrow is rich in tales and details—too rich at times. Jones tries to fit in every comic book writer, artist, inker, letterer, and publisher who ever lived. My beef with Jones, though, is not what he put in, but the story he wanted to tell but couldn't—the tale of the very private Jack Liebowitz, who was the real man of tomorrow. He turned a seat-of-the-pants outfit into a powerhouse, extending distribution, building a licensing arm, taking the company public, and selling it finally to ex-Time Warner chief Steve Ross—all this from a man who began as a socialist. In a world filled with would-be Supermen, he was the one man who would be Clark Kent. ■

—By Robert J. Rosenberg

In Brief

Fast Takeoff

BLUE STREAK

Inside JetBlue, the Upstart That Rocked an Industry

By Barbara S. Peterson; Portfolio; 262pp; \$24.95

The most interesting character in *Blue Streak: Inside JetBlue, the Upstart That Rocked an Industry* isn't mentioned much. The book zeroes in on JetBlue Airways Corp. founder and media darling David G. Neeleman. But Neeleman rarely escapes the shadow of Southwest Airlines Co.'s Herbert D. Kelleher. Herb breezes into this narrative infrequently, each time stealing the show. Kelleher, who fired Neeleman in 1994, months after buying Neeleman's former airline, Morris Air Corp., is a hard-drinking, high-living Texan who has outfoxed—and out-earned—the major carriers for a quarter century.

Blue Streak author Barbara S. Peterson, a contributing editor at *Condé Nast Traveler*, paints Neeleman as a man-who-would-be-Herb. He's part shrewd entrepreneur, part customer advocate—Neeleman aims to "bring humanity back to air travel," she writes—and part human sponge. The managers Neeleman assembles to build

JetBlue are drawn primarily from Southwest and Britain's Virgin Atlantic Airways Ltd. Like cost-obsessed Southwest, JetBlue started with a single type of plane, treated employees well, and stressed quick-turnaround, point-to-

point service. And like Virgin, JetBlue used buzz and hip marketing to present the flying experience as much more than simply getting from Point A to Point B.

Too often, Peterson seems to have "drunk the blue Kool-Aid," the phrase JetBlue insiders apply to true believers in the carrier. For example, she once describes Neeleman—a squeaky-clean Mormon father of nine—as "young, fit, an advertisement for clean living." But readers escape sugar shock when Peterson moves beyond personalities to detail how Neeleman crafted more of a branded travel experience than an airline. For that alone, Neeleman's place in the often-unfriendly skies is secure. ■

—By James E. Ellis



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BY STEPHEN H. WILDSTROM

The Treo 650 Is Leading the Pack

How does the best product stay on top in a world where competitors can quickly imitate good ideas? By getting better, of course. That's what palmOne has done to keep its Treo combination phone, e-mail terminal, and PDA comfortably ahead of improving BlackBerrys from Research in Motion and Pocket PCs from Microsoft and its partners.

The changes in the new Treo 650 are evolutionary but important. The first thing you notice is a new screen with four times the resolution of the Treo 600s. What had been a weak point is now the equal of any handheld screen on the market. The new display and better software greatly enhance the camera feature, which was all but useless in the original. Battery life was another big deficiency of the earlier Treo. PalmOne corrected that by moving to a replaceable battery, so you can always carry a spare. And even if the battery runs completely dry, the use of "flash" memory preserves your data and programs.

The keyboard has also been overhauled. A second shift key has been added to the right of the spacebar. The three rows of keys now curve slightly, and the keys themselves are flatter and slightly bigger, although a bit closer together. The combined effect makes it a little easier to type accurately.

A NUMBER OF OTHER CHANGES make the Treo, always a better phone than most of its competitors, even more phonelike. Thanks to handset-style backlighting, it's easier to see all the keys in the dark, and new "send" and "end" buttons make it simpler to make and terminate phone calls. Navigation keys, which had been divided between the top and bottom of the keyboard, have all been clustered around the five-way control at the top. And the addition of Bluetooth makes it possible to use wireless headsets or hands-free setups in cars.

The Treo 650 is offered initially only by Sprint PCS, although other carriers will follow in the U.S. and elsewhere. It costs \$450 with a two-year service agreement; Sprint offers unlimited data service for a \$15 supplement to a voice plan.

What are the new alternatives to the Treo? Carriers offer a variety of products based on Microsoft's Pocket PC Phone Edition software, but in general, a lack of integrated keyboards has limited their usefulness for e-mail. The big-screen design of Pocket PCs makes it tough to add a keyboard. But T-Mobile's HTC found a solution with a product sold in the U.S.



by Sprint as the Audiovox 6601 (\$480 with two-year activation; unlimited data for \$30 plus a voice plan) and in Europe by T-Mobile as the MDA III.

In its normal state, the Audiovox is about a half-inch longer and wider than the Treo—still small enough to fit into a big pocket. But the display slides up to reveal a keyboard. The keys are little plastic bumps, as opposed to the Treo's real buttons, but they're raised enough to allow accurate typing.

The bigger problem is that Microsoft has not integrated the keyboard properly into the software. With both the Treo and the BlackBerry (page 80), you can handle just about all functions from the keyboard and navigation keys. But the Pocket PC frequently requires clumsy taps on the touchscreen. This is particularly awkward on the Audiovox when the keyboard is open, extending the length of the device to nearly seven inches.

I used the Audiovox with Good Technology's wireless mail, contact, and calendar service, which works around the problem by using many of the keyboard shortcuts that are standard on the Treo, such as hitting "d" to delete a particular message. But by leaving this key capability up to the application providers, Microsoft essentially forces the user to learn a different set of shortcuts

The phone, e-mail, and PDA combo has stayed ahead of the BlackBerry

for every individual program. The Microsoft-based devices keep getting better, but so far Palm has managed to remain at least one step ahead. ■

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VISUALIZING BUSINESS INTELLIGENCE

INFORMATION OVERLOAD

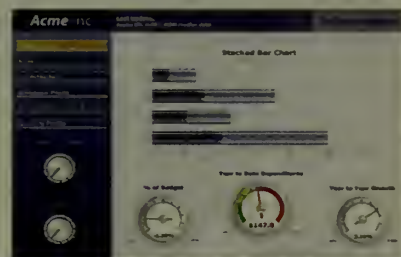
It's a condition plaguing virtually every business decision-maker, from financial analyst to CEO. Not only are today's decision-makers being confronted by too much information, but vital data is being generated at such a rapid pace that most people cannot internalize it fast enough to make the instantaneous decisions hyper-competitive business environments demand.

And that's not the worst part. Even when actionable data is available, it's typically presented in a format only optometrists would love: dense Excel files and static PowerPoint charts that tax the eyes as much as the mind. Critical data relationships are difficult to discern. And trying to intelligently compare alternative scenarios or to analyze the behavior of key variables over time is a task that, all too often, strains the abilities of even the most seasoned executives.

Faced with similarly mission-critical decisions, airline pilots have long immersed themselves in ultra-realistic flight simulators that vividly depict every scenario and consequence until they know instinctively which course of action is best in any circumstance. Until recently, business executives have lacked the same powerful interactive tools that would enable them, at a glance, to know which choices were right for their business, and to communicate

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BY LAURA D'ANDREA TYSON

Offshoring: The Pros And Cons for Europe

American companies lead the world in offshoring business services to India and other low-cost countries. But faced with stiff American competition—due in part to the falling dollar—more European companies, especially British ones, are starting to offshore services. Will European economies benefit from the trend? The answer turns out to be yes—if certain conditions are met.

Even then, gains will not be evenly distributed: Workers and communities that lose jobs may suffer considerable pain.

Incentives for offshoring by European companies are huge: Services costs can drop by 50% to 60%. And the scope for offshoring is vast. By IBM estimates, less than 8% of the \$19 trillion spent each year on sales, general, and administrative expenses has been outsourced so far. Many companies say they can offshore half or more of this work.

Offshoring services should benefit Europe's economy: Companies will become more competitive so they can raise profits and reduce prices. This will bolster demand and keep inflation in check. Companies can invest to improve existing products or introduce new ones. Greater demand will spark innovation and create jobs to replace those that have gone abroad.

With flexible labor markets and strong economic growth, countries that offshore services can shift labor to higher-value activities, boosting productivity and living standards. And countries that attract outsourced jobs will enjoy improved productivity and higher growth, so they can buy more exports from offshoring nations. Applying this logic, the McKinsey Global Institute estimates that for every dollar U.S. companies spend on offshoring work in India, the American economy gains \$1.14, while India gets 33¢. Thus, there are "win-win" returns for both high-wage and low-wage countries.

BUT A CLOSER LOOK AT THE LOGIC reveals that benefits to the offshoring nation depend on two critical assumptions: the redeployment assumption (or what percentage of workers who lose jobs find new ones); and the recapture assumption (or what percentage of the wages paid in lost jobs are recaptured by the wages paid in new ones). For example, the McKinsey calculation of gains from U.S. offshoring is based on the assumption that 69% of displaced service workers will find new jobs within one year and that these workers will earn 96% of their former wages. These assumptions are based on the U.S. economy's performance between 1979 and 1999.

More recent data from 2000-03 suggests these estimates may be overly optimistic. Even according to the McKinsey assumptions, nearly one-third of American workers who lose their jobs will not find other jobs within a year. Older workers with less education are the most vulnerable.

In Continental Europe and Japan, where employment practices are more rigid than in the U.S., redeployment of displaced workers is likely to be much lower. If low enough, this could cause an increase in the overall unemployment rate and a reduction in overall income in the offshoring country. In a recent study, McKinsey concludes this might be the case in Germany, where redeployment might reach only 40%. So German companies and shareholders could benefit from offshoring, while workers and the overall economy suffer.

By contrast, labor markets in Britain are more flexible, and offshoring is apt to generate both company-level and economywide gains. This is indeed the conclusion of the Advanced Institute of Management Research, which finds

that service jobs have continued to grow strongly in Britain despite rapid growth in the offshoring of similar jobs by British companies.

Offshoring is a process of creative destruction. The challenge for governments is to develop policies that ease the pain that offshoring inflicts and speed workers' transition to new jobs. So-called wage insurance policies are a promising policy response. Such programs are designed to cover the loss of wages for displaced workers until they

Wage insurance for displaced workers can help ease the transition

gain new employment or to make up the difference between the old wages lost and wages paid for new jobs. A small scheme of wage insurance was introduced in the U.S. as part of the 2002 trade legislation, but it is limited to older workers who lose manufacturing jobs to foreign imports. It is time to expand this program to workers who lose service jobs to offshoring.

The British government should introduce its own wage insurance program. Such a program would be in keeping with Labour's "Third Way" approach that values both market flexibility and social equity and that has been the foundation of Britain's strong performance over the past decade. ■

Laura D'Andrea Tyson is dean of London Business School (ltyson@london.edu).

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BY JAMES C. COOPER & KATHLEEN MADIGAN

The Coming Battle Between Profits and Prices

Pricing power is rising, but so are costs—and that will soon squeeze margins

U.S. ECONOMY

The latest signs of a stronger economy, as well as twin surprises in the October price data, have heightened worries about an inflation threat, if not right away, then sometime in 2005. But the most important trend in the realm of pricing is the developing tug of war between prices and profits. Companies are dealing with

heightened cost pressures, whether on the labor front or from higher commodity prices. And solid demand and a weaker dollar mean U.S. companies have gained some ability to pass along these rising expenses. But it is still uncertain how much of the bigger tab companies will be able to pass through to consumers, and how sharply the costs will eat into profit margins.

What makes the cost squeeze a threat to the profit outlook is the ratcheting down of productivity growth. A slowdown in the growth of output per hour is a normal trend at this stage of an expansion, though the easing may be more acute this time around since U.S. businesses had been logging efficiency gains averaging 4.2% in the first three years of recovery. That's a rate well above productivity's long-run growth trend.

But in 2005, businesses will not be able to rely on higher productivity to cover the increases in labor costs coming as the job markets tighten. Already, hourly compensation has risen faster than productivity in each of the past two quarters, and that pattern is likely to continue. As a result, unit labor costs will keep rising, instead of shrinking, as they did from early 2002 to the first quarter of 2004.

Businesses will face some hard choices as a result, and their decisions will go a long way in determining the outlook for both economic growth and inflation next year: If prices don't keep up with costs, then profit margins will get squeezed by more than now forecasted. That puts capital spending and the stock market at risk. But if prices do keep up, then overall inflation could pick up more than expected, creating headaches for both bondholders and policymakers at the Federal Reserve.

BESIDES PRODUCTIVITY'S DOWNSHIFT, the biggest change in the price outlook for 2005, compared with 2004, is the different global environment. From its peak in February, 2002, until this October, the dollar has fallen by 13% on a broad trade-weighted basis. Although the fall has not been across the board against the U.S.'s major trading partners (the euro and yen have strengthened far more than the currencies of most emerging nations), the nearly three-year decline in the dollar has finally caused some inflation in imported goods.

For all nonoil imports, the swing has been significant. In February, 2002, these prices were falling 5.1% from the previous year. In October, 2004, they were up 2.7% from a year ago. Much of that acceleration came from raw materials, even outside of energy, but a shift was clear for imported consumer goods as well. Prices there fell 1.3% in the year ended in February, 2002. By last month they were rising 0.5%.

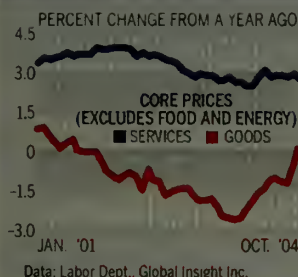
That swing has given U.S. manufacturers the opening they needed to mark up their own price lists. Producer prices of core consumer goods, which exclude food and energy, have risen 1.7% over the past year, a sharp change from the price declines posted in 2002 and early 2003.

On the retail level, prices of consumer goods are finally beginning to emerge from outright deflation. From the start of 2002 until September, 2004, core consumer goods prices were falling, dropping on a yearly basis by as much as 2.6% in November, 2003. But the declines began to lessen in 2004. And in October, core consumer goods prices posted a small 0.1% gain from a year ago.

BEAR IN MIND, the recent spate of deflation was an anomaly caused mainly by the combination of the dollar's past surge and a global slump in demand, not to mention China's increased penetration into U.S. markets (page 102). In the first two years of this recovery, the drop in goods prices offset much of the runup in service inflation, resulting in a slowdown in overall core inflation.

Those global forces haven't gone away, but the re-emergence of goods inflation signifies a return to more normal conditions in goods pricing. That trend should continue, and it means that goods deflation is no longer balancing out service inflation (chart). Since the end of last year, the shift from price cuts to hikes in goods has accounted for nearly all of the 0.9 percentage-point

WHERE INFLATION IS WARMING UP



increase in the annual pace of overall core inflation, even as service inflation remained nearly stable.

The pickup in inflation all but assures that the Fed will continue to lift interest rates at a steady pace next year. Policymakers have doubled the federal funds rates since June, to 2% currently. But because inflation is also higher, the real funds rate is still essentially zero. That means policy is far more accommodating to growth and inflation than the Fed wants.

WHAT'S IMPORTANT TO NOTE is that the uptick in core consumer inflation this year has not been nearly as big as the rise in core prices in the earlier stages of processing. For example, prices for unfinished intermediate goods have shot up by 7.8% from a year ago, but prices for finished goods are up only 1.8%. Businesses are absorbing some of that acceleration.

And even as many businesses raise their prices, they also face bigger bills for labor. Job growth in the U.S. should continue to increase in 2005, resulting in tighter labor markets and higher payroll costs at a time when productivity is slowing. Already in the third quarter, nonfarm productivity was up at an annual rate of just 1.9% from the second quarter when it grew a more impressive 3.9%. Last quarter's gain barely offset half of the 3.6% rise in compensation, leading to a 1.6% jump in unit labor costs. That increase was equal to the 1.6% rise in prices (chart).

In 2005, expect to see more businesses trying to bridge the gap between the prices they pay for labor and

materials and the prices they receive for their wares. That will most likely result in somewhat higher core inflation. However, intense global competition has not gone away, and it will remain the great enforcer for U.S. pricing. Over the past year, the dollar has actually risen against the currencies of countries that make up 40% of the U.S.'s

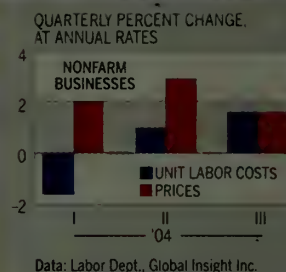
trade volume—mainly Asian and Latin American nations.

Of course, some companies will be more successful at raising their prices to meet their costs. And others will refocus their productivity efforts. But most will probably have to suffer some squeeze in their profit margins. Shareholders will be unhappy, but for

the economy as a whole, the strains won't be that damaging. As even Fed Chairman Alan Greenspan has pointed out, margins now are sufficiently high that most corporations can absorb some of their higher costs.

So how will the tug of war between prices and profits play out in 2005? Look for some combination of rising inflation and a downward pull on earnings. Although many businesses will enjoy a shade more pricing power, it will probably not be sufficient to overcome all of the cost pressures companies will face. ■

LABOR COSTS CATCH UP WITH PRICES



SOUTH KOREA

A Bad Situation Is Set to Get Worse

SOUTH KOREA'S struggle to regain its economic health is getting tougher, and the prognosis is not encouraging. Already beset by falling consumer demand, the economy now faces the prospect of slower growth in exports, and overall growth seems likely to weaken further in 2005.

Real gross domestic product in the third quarter grew at an annual rate of 2.6% from the second quarter and 4.6% from a year ago.

The government conceded that growth in the fourth quarter may be even slower. The third-quarter advance was weaker than it looked, given that two key pluses were slower growth in imports, which shows weaker domestic demand, and a gain in inventories, which

appears to have been unintended.

Consumer spending declined last quarter for the fifth quarter in a row, reflecting the continued fallout from the bursting of the credit bubble two years ago, leaving 16% of the population delinquent in their repayments. Spending is unlikely to rebound anytime soon: Consumer confidence fell to a four-year low in October. Real wages have slowed

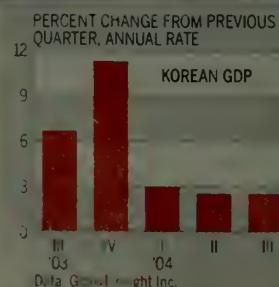
sharply as inflation has picked up to 4%. And joblessness of 3.5% is close to a three-year high.

More important, exports rose by the smallest amount in three years, pulled down by slower global growth, cooler tech demand, and a strong currency. The Korean won is up some 12%

vs. the dollar this year, touching a seven-year high in mid-November. Exports will slow further as China, Korea's main export destination, tries to rein in its economy. Even when export strength returns, labor markets may not benefit, since a large portion of Korean factory output has been relocated to China. Korea's long-term challenge is to find a way to compete without hollowing out its manufacturing base.

For now, policymakers are boosting government spending while cutting taxes and interest rates, but to little avail, as households try to build up their low savings and pay off existing debts. Economists expect growth to slow from 4.9% this year to 4.4% in 2005. But unless consumer spending stabilizes, the slowdown could be sharper. And as officials acknowledge, the economy must grow at least 5% to generate enough jobs to absorb a growing labor force. ■

GROWTH IS LOSING STEAM





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by the parent company of Kraft Foods, Philip Morris International and Philip Morris USA

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CURRENCY

WHY THE DOLLAR IS GIVING WAY

The problem: America's yawning deficits—and foreign investors' waning interest in financing them

WHAT'S GOING ON with the dollar? After falling steadily for the better part of two years, the greenback showed signs of stabilizing in the spring and summer. Massive dollar purchases by Japan and other Asian central banks, hopes that the U.S. trade deficit was peaking, and expectations that the Federal Reserve would hike interest rates rapidly all combined to put a floor under the U.S. currency.

SEOUL The dollar is at a seven-year low against the won

But in the last few weeks that floor has suddenly given way. The dollar is once again on the decline, dropping to a record

low vs. the euro, a four-year low vs. the yen, and a seven-year low against the South Korean won. Behind the latest downdraft: a stubborn U.S. trade deficit that refuses to stop climbing and growing hints from Japan, China, and other Asian nations that they might be willing to countenance an appreciation of their currencies to help narrow the shortfall. Moreover, Washington's lack of concern about the plunge has added fuel to the fire. Treasury Secretary John W. Snow has all but ruled out action to stop the dollar's decline, while Federal Reserve Chairman Alan Greenspan suggested on Nov. 19 that a fall is inevitable. Put it all together, concludes Robert D. Hormats, vice-chairman of Goldman Sachs International, and "it's an invitation to sell the dollar."

So far the drop has been largely be-

nign. Despite the dollar's 5% slide against major currencies in the last month and a 25% fall since its peak in early 2002, the global economy has continued to grow, and stock and bond markets have been steady. But history suggests that caution is in order. Currency markets are prone to excess—and an uncontrolled fall of the dollar would be good for no one. It would disrupt financial markets worldwide and undercut global growth. "You could have a couple of rough patches," says ex-Fed official Edwin M. Truman.

The renewed drop already has led to heightened transatlantic tensions. European Central Bank President Jean-Claude Trichet, worried that the strengthening euro could undercut the region's fragile recovery, has called the currency's rise

SEOKYONG LEE/BLOOMBERG NEWS

against the dollar "brutal." German Chancellor Gerhard Schröder agrees. "The euro-dollar rates are a cause for concern," he told reporters in Berlin on Nov. 20 before an address to Snow and other economic policymakers from the Group of 20 nations. "The cause is clear," he added. "It can be found in the double deficit in the U.S.—the deficit in the federal budget and the current account."

Snow disagrees. He pins much of the blame for the gaping U.S. trade shortfall on what he calls a "growth deficit" in the rest of the world, especially in Europe. In the third quarter, growth slowed to a virtual standstill in Germany and France. He wants Europe to reform its product and labor markets and boost its economies so it can buy more imports from the U.S. and elsewhere.

At the heart of the dollar's difficulties is the ballooning U.S. current account deficit and the growing wariness on the part of foreign investors and central banks to finance it. Thanks in part to sky-high oil prices, the U.S. deficit looks on course to hit a record \$600 billion this year. At close to 6% of America's gross domestic product, that's up from \$496.5 billion last year and \$421.7 billion in 2002. Economists Nouriel Roubini of Columbia University and Brad Setser of Oxford University reckon that the deficit could rise to well over \$650 billion next year.

CLOSING THEIR WALLETS

FOREIGN INVESTORS and central banks are already showing signs of fatigue in funding that ever-rising U.S. shortfall. According to Treasury Dept. data, foreign investors bought a net \$158 billion worth of long-term U.S. securities—both stock and bonds—in the third quarter, while foreign central banks purchased \$42.4 billion. That's down sharply from the \$176.3 billion and \$91.3 billion they bought, respectively, in the first quarter.

In a speech in Frankfurt on Nov. 19, Greenspan predicted that foreign investors would eventually get their fill of dollar assets and that a lower greenback and higher U.S. interest rates would be needed to keep them investing. That may be what's happening now. According to Catherine L. Mann of think tank the Institute for International Economics in Washington, global investors are chock-full of dollars after a buying binge that pushed



GREENSPAN AND TRICHET The slide has hiked U.S.-EC tensions

the greenback to fall toward 100 yen without stepping into the market to stop it. That's in sharp contrast to earlier this year, when it bought a massive \$140 billion in the first quarter alone to push the dollar above 110 yen. Behind the apparent shift in strategy: a growing confidence in the durability of Japan's recovery. South Korea, too, has let its currency appreciate, by some 7% over the last month, though it has since stepped into the market to stabilize the won.

GRADUAL IS O.K., BUT...

STILL, THE BIG KAHUNA is China. Faced with a \$160 billion trade deficit with China alone, the U.S. has been pressing Beijing to loosen its hold on its currency, which has been pegged at 8.3 to the dollar since 1994. At the Group of 20 meeting in Berlin, Central Bank of China Governor Zhou Xiaochuan said Beijing is "re-viewing its old foreign-exchange control systems."

What's most likely, experts say, is that China will accept a small appreciation of its currency sometime in the next six months by widening the range in which the yuan trades.

In anticipation that a Chinese move will lead to a

regionwide currency revaluation, hedge funds and other speculators have sold U.S. dollars short and loaded up on South Korean won, Taiwan dollars, and Japanese yen. According to data from the Chicago Board of Trade, speculators were short the dollar on nearly 275 million futures contracts on Nov. 16, compared with 90 million on September 28. The selling began in late September as China's attendance at its first meeting of the Group of Seven industrial nations fanned speculation that Beijing would make a move on its currency. It acceler-

the U.S. currency's share of their stock-and-bond portfolios up to nearly 50%, from 30% in the early '90s.

Even foreign central banks are diversifying their portfolios. "They have made a strategic decision that the dollar is vulnerable," says David Gilmore of consultant Foreign Exchange Analytics. First Deputy Chairman Alexei Ulyukayev of Russia's central bank rocked currency markets on Nov. 23 when he suggested that the bank might sell off some of its dollars for euros. "Most of our reserves are in dollars, and that's a cause for concern," he told reporters in Moscow. "Looking at the dynamics of the euro-dollar rate, we are discussing the possibility of changing the reserve structure."

Russia is hardly alone. Signs are growing that Asian central banks might be willing to cut back on their dollar purchases and allow their currencies to appreciate against the dollar. Japan so far has allowed

Russian and Asian central banks are mulling a shift away from dollars

DOWNWARD MARCH



ted after President George W. Bush's election on Nov. 2 as speculators bet that the Bush Administration would not stand in the way of a further dollar decline and also would do little to bring down the U.S. budget deficit.

The sheer size of the speculative selling means the dollar might be susceptible to a short-term snapback as hot-money traders close out their bets and take profits. But short-term gyrations aside, most experts believe the dollar's long-term direction is downward. "The dollar has a lot further to fall—especially against Asian currencies," says Brian Harvey, senior strategist at State Street Corp.'s State Street Global Markets.

Provided the dollar's fall is gradual, it should prove manageable for the world economy. But that doesn't mean there won't be some dislocations. The higher inflation and interest rates brought on by the weaker dollar will mean that U.S. consumers will have less money in their pockets to spend. And U.S. companies will find it harder to make acquisitions overseas. "Many of us will feel a little bit poorer," says Kenneth S. Rogoff, former international Monetary Fund chief economist and now a professor at Harvard University. But Japan and Europe could be hit harder unless they take action to boost domestic demand to offset the loss of their exports.

Of course all bets would be off if the dollar suddenly nose-dived, dragging U.S. stock and bond prices down with it. That would raise the risk of a global recession. After all, it was a currency clash between the U.S. and Germany in 1987 that helped trigger the crash that pulled down stock prices by nearly 25% in a single day. Policymakers take note: When it comes to currencies, it pays to be careful. ■

—By Rich Miller in Washington, with Jack Ewing in Frankfurt, William Boston in Berlin, Dexter Roberts in Beijing, and bureau reports

CARMAKERS

THE AUTO DEFICIT: STUCK IN NEUTRAL

A weaker dollar isn't an instant fix for U.S. carmakers' trade woes



GIVEN THE NUMBER OF Japanese car plants that have opened in the U.S. in recent years, it may come as a surprise that the auto industry still accounts for nearly one-quarter of America's trade deficit. But it's true: Last year the U.S. imported \$128 billion more in vehicles and auto parts than it sent abroad—double the level of six years earlier. The trade deficit in autos was nearly as big as the one in oil. The Big Three say the dollar's strength, particularly vs. the yen, has given foreign rivals an unfair advantage.

So will the falling dollar shrink the trade deficit by giving U.S.-made vehicles an edge? With the dollar down 24% against the yen since early 2002, Detroit is a natural place to look for an improvement in the trade balance, because the auto sector is so huge. Domestic carmakers also have the capacity to step up production to replace imports and increase exports. In consumer goods, by contrast, the weaker dollar won't shrink the deficit much because domestic pro-

duction capacity has withered away. A narrowing of the auto trade deficit would go a long way toward correcting the huge overall imbalance between what Americans consume and what they produce.

The outlook, though, is mixed. A weaker dollar will help shrink the auto trade deficit all right, but it's no instant cure. The trade gap in autos is a consequence of how the world's auto makers have constructed their global supply chains—and they aren't about to reconfigure them just because the dollar is down. Unless the shift is large and lasting, they're more likely to respond tactically. Foreign auto makers will try to hold the line on prices to maintain U.S. market share, analysts say. Even if they are forced to raise prices on exports to the U.S., Detroit may not seize the chance to regain lost market share. More likely, analysts say, U.S. auto makers would raise their own prices in tandem with import prices to restore badly eroded profit margins. Says Sean P. McAlinden, chief

LEAVING KOREA
Kia cars ready for shipping overseas

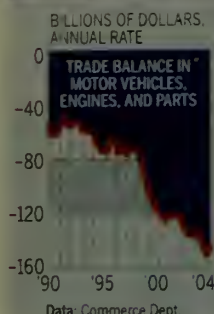
...and the dollar tumbles



economist at the Center for Automotive Research in Ann Arbor, Mich.: "In this business, normal economic rules of the universe don't apply."

In the short term, a weaker dollar could even widen the deficit. Why? Because Americans won't immediately switch to cheaper domestic alternatives.

THE AUTO GAP



They'll buy nearly the same number of foreign-made autos but pay more for each one, increasing the import bill. That's the infamous effect that economists call the "J Curve."

America's last experience with a cheap dollar shows how persistent the auto trade gap is. The dollar fell 40% against the yen in the first half of the 1990s, yet the auto trade deficit with Japan shrank by just 20%—and rebounded as the dollar strengthened. Likewise, the trade deficit with Germany is up 8% so far this year, even though the dollar has fallen 35% over the past three years against Germany's currency, the euro.

NO SWAPPING PARTS

PART OF THE PROBLEM is that the global flow of autos and parts can't be changed quickly. True, the Japanese are adding capacity in the U.S., which will trim some of the deficit. But parts production, which accounts for 20% of the deficit, can't be moved so fast. "Car-makers are unlikely to... switch in mid-model life to U.S. parts" even with a cheaper dollar, says Keith Head, an economist and industry specialist at the University of British Columbia's Sauder School of Business. They'll be even less likely to switch if they aren't sure the dollar's weakness will last.

Keep in mind, too, that the dollar isn't falling against all currencies. It has risen against the Mexican peso. Both U.S. auto makers and Japanese transplants are sourcing more parts from Mexico. The result: The U.S. auto trade deficit with Mexico soared to \$27 billion last year—second only to the \$44 billion deficit with Japan. That's one more reason currency moves won't quickly change the outlook for auto trade. It may give U.S. carmakers some much-needed breathing room. But wipe out the auto trade deficit? Probably not. ■

—By Peter Coy in New York

COMMENTARY

BY DAVID WELCH

Sorry, Detroit. The Garage Is Full

Demand may slow as rates rise and incentives fall

MICHELLE POLLAK HAS a seriously crowded garage. In the past three years, Pollak has added three new cars to the family fleet, bargaining for cheap deals on her Volvo wagon and her husband's Lexus SUV. The couple even picked up a slightly used Honda minivan for the au pair, who cares for their two kids. Including an old Mazda RX-7 convertible and an aging minivan, the family now has five vehicles. Says Pollak:

"We're not adding cars anytime soon."

If many more Americans decide the garage is full, carmakers could be headed for a patch of rough road. Thanks to low interest rates and ever-sweeter incentives, sales have been sky-high for five years. Company execs, pointing to a stronger economy and millions of young drivers coming on stream, expect robust sales to continue. But with rising rates almost certain to make car payments pricier, some economists question if enough eager shoppers still exist to keep sales humming—let alone spark the kind of growth that would let Detroit slash rebates and rebuild profits. Says Bank One Corp.'s ex-chief economist, Diane Swonk, who recently started a new venture: "Sales are artificially high."

Headwinds

WHY THE GLOOM? For the past three years, as auto makers have thrown ever better deals at buyers, sales have remained essentially flat at around 16.7 million vehicles. Even if sales hit about 16.8 million, as analysts expect, that won't be enough to help Detroit. Ford and General Motors are already having a tough time making money selling cars, while Chrysler has only recently gotten a lift from some hot models. And if rising

rates cause sales to drop, look out. Swonk and some other economists say sales could fall as low as 16 million in 2006. That may not sound like much of a fall, but the impact would be huge. Comerica Bank Chief Economist David Littman says once sales fall below 16.25 million, it will be difficult for the Big Three to stay in the black.

Making matters worse, Asian makers are adding plenty of new capacity in the U.S. Already, new additions like Honda's recent expansion of its Odyssey minivan plant in Lincoln, Ala., or Hyundai's new factory in Montgomery, Ala., are putting pressure on Detroit. And over the next two years, the Japanese and Koreans will

IS THERE A BUBBLE IN AUTO?





HONDA IN ALABAMA

Asians add U.S. capacity

no pent-up demand.” True enough. The average household now has 2.1 cars—an all-time high. And a lot of those

vehicles are new. The car fleet is aging, but trucks, SUVs, and minivans—now half the market—are on average about 6½ years old compared with 7½ in 1999. And while owners used to replace vehicles every five years, better quality means they’re now hanging on to them longer, according to auto analyst R.L. Polk & Co.

What’s more, the rich incentives of recent years pulled a lot of people who typically would have bought used cars into the new-car market. Now, rising interest rates could drive them back out. Even if auto makers keep their low interest-rate deals, many of these buyers could face higher credit-card debt or rising payments on adjustable-rate mortgages. As a result, many may have less disposable income available for a new car.

The carmakers, of course, see plenty of reason for continued optimism. For one thing, auto sales don’t exceed their historic 3.8% share of gross domestic product—meaning they are not out of line with the rest of the economy. Car sales do well when consumer confidence and job growth are strong. Both are now on the rise, and auto makers feel the overall economy will remain healthy enough to sustain strong demand. Says Ford Chief Economist Ellen Hughes-Cromwick: “The fundamentals for vehicle-buying should be good.”

Eventually, the demographics could favor auto makers, too. The children of baby boomers and the steady arrival of immigrants have added 2 million net new drivers to the population every year since 1999. The U.S. will boast 8 million new households by 2011, says Sean McAlinden, chief economist at the Center for Automotive Research. He believes all those new drivers could help push sales to 18 million vehicles a year by decade’s end.

But no matter how rosy the long-term outlook, the industry may be in for a couple of rough years. Over the next two years, the big players will send at least 50 new or freshened models a year to showrooms, up from about 30 in a typical year. Raj Sundaram, president of Automotive Leasing Guide, says the industry needs to sell at least 17.5 million vehicles in each of the next two years to absorb all the new cars. “I don’t see how they’ll do it,” he says. Without some bona fide hits and a reenergized economy, today’s packed driveways could mean empty coffers in Detroit. ■

bring online enough extra production to build 600,000 more vehicles in the U.S. each year. Presuming those cars find buyers, the market would have to increase by the same amount to prevent Detroit from losing sales. Says Deutsche Bank auto analyst Rod Lache: “We have a lot of headwinds.”

Those winds seem unlikely to cause much damage until 2006, say most analysts. True, the banks’ prime lending rate has risen one percentage point, to 5%, this year. But with rates still near historical lows, auto makers have been able to continue offering attractive incentives. Economists expect rates to remain close enough to today’s levels in ’05 that auto makers will continue to be able to load on the deals. Just as important, Littman notes real disposable income is still

growing more than 4%, which augurs well for sales through the next year.

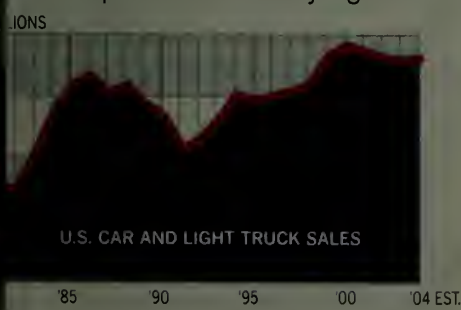
But by 2006, higher rates could start to pinch, making it harder for auto makers to offer cheap financing. Goldman, Sachs & Co. analyst Gary Lapidus estimates that, unless the economy improves, a one-point rise in rates over the next 18 months or so could trim sales by up to 600,000. That would push sales down toward 16 million vehicles—a level not seen since 1998. To offset that, he says, average incentives would have to rise an additional \$1,100, to about \$5,000.

Uncertain Road

GM HAS ALREADY MOVED to counter rising rates. The auto giant is offering buyers a chance to lock in 0% or other low-interest loans for a purchase several years in the future if they buy a car now. It’s a risky move: GM doesn’t know how high rates will be when buyers come calling with vouchers for lower interest rates.

The big question is whether such deals have let carmakers borrow sales from the future. Americans have shown an astounding willingness to buy more and bigger vehicles. Since 1997 the real value of cars, SUVs, and minivans owned by U.S. households has surged 47%—twice the growth of residential housing stock. “We pushed up sales by buying them,” says Van E. Jolissaint, Chrysler Group’s chief economist. “There is certainly

...has kept auto demand sky high



Ward's Automotive Reports

TELECOM

THE FIBER-OPTIC QUAGMIRE

The Baby Bells want to enter cable's market—without paying the same fees

THE BABY BELLS HAVE been making headlines lately with bold plans to take on the cable industry. SBC Communications Inc. aims to spend as much as \$6 billion by 2007 to build a state-of-the-art fiber system connecting 18 million homes to TV programs, as well as voice and Internet data. Verizon Communications Inc. has an even more technologically ambitious goal: spending \$2.4 billion by the end of 2005 to provide video and other services to some 3 million homes. BellSouth Corp. has big plans, too.

It's heady stuff. The promise of new and exciting video services delivered via ultrafast fiber-optic cable would seem to offer nothing but benefits to consumers. Yet the Bells are running into a roadblock from an unexpected quarter. From Florida to California, a host of cities and towns across the country are threatening to slow the Bells' rollout by demanding multibillion-dollar franchising fees even as they

insist that the Bells provide their high-end video service to every household in their communities.

Underneath the fracas a huge policy debate looms as local governments grapple with an unsettling question: Is it better to speed technological progress by letting the Bells offer service to proven big spenders who live in upscale neighborhoods, as the Bells insist they must to make a return on their massive investments? Or should cities require the Bells to provide universal access, as they already do for cable operators as well as phone-service providers and other utilities?

Policy isn't the only concern. At stake is a huge pot of money and the future control of lucrative markets. The controversy has pitted the telcos against the cable companies, with local governments caught in the middle. Under provisions of current telecommunications law, the cable industry pays about \$2.4 billion a year to local communities to secure franchises

that give them the right to run their cable lines under streets, sidewalks, and other public space. The cable industry is fighting to force the Bells to pay the same fees they pay. Any other arrangement, they argue, would give the Bells an unfair advantage.

MILES OF CABLE

The regulatory mess could slow the Bells' rollout

HELP FROM THE FCC?

THE TELCOS INSIST they shouldn't be subject to the same rules as the cable companies because they are new entrants to the market: They will deliver the competition that will drive down prices. What's more, executives argue, the Bells have coughed up billions of dollars in local dues for decades via their regulated phone business. "A franchise obligation is right for the first provider," says Dorothy Atwood, senior vice-president of regulatory policy at SBC. "But when you're talking about competitive alternatives, you want to encourage that investment."

It's a tough call for communities. But if the Bells have their way, it won't be up to city officials to decide. SBC is partly resting its case on a recent Federal Communications Commission ruling exempting voice-over-the-Internet telephony service from local regulations. SBC claims the ruling also applies to its Internet-based video technology.

The FCC has said it may have the authority to preempt franchising obligations. Meantime, Verizon has been lobbying California state legislators to eliminate franchising rules even as it pushes Congress for a rewrite of telecom-

Big Debate

Local communities have a lot of incentive to strike deals allowing Bells to provide TV service over new fiber-optic lines. But many hurdles remain:

THE UPSIDE

■ **TAX REVENUE** Towns and cities collected \$2.4 billion from cable companies last year and could collect billions more from the Bells.

■ **NEW COMPETITION** The Baby Bells' entry into video will give consumers more choice and potentially lower prices.

■ **BETTER SERVICE** With ultrafast data-transmission speeds, the Bells are promising more video on demand and more local programming.

THE HURDLES

■ **REGULATIONS** The Bells say they should be exempt from having to negotiate city-by-city for video franchises as cable companies must do now.

■ **FEES** Many cities want the Bells to pay the same 5% franchise fees that cable companies pay. The Bells say they should be exempt.

■ **SERVICE COVERAGE** Most cities insist that telcos provide everyone in their community with access to service. The Bells want to start service only in the most affluent neighborhoods.

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munications law. But success at those efforts is far from certain. "The regulatory angle has turned into much more of a quagmire than the Bells expected," says Scott Cleland, telecom analyst at Precursor Group, a telecom-research firm in Washington, D.C.

Even so, many local communities welcome the new competition that the Bells would bring. Cities such as Beaumont, Calif., and Tulsa have moved swiftly to sign up Baby Bell video service. "It was very smooth," says Alan Kapanicas, city manager in Beaumont.

Yet many financially strapped cities are eager for new sources of revenue. Typically, cities charge companies for the right to lay cables and wires underneath the streets. And current telecom laws support those levies. "The Baby Bells would like to be in our rights-of-way free of charge,"

Cash-strapped cities are eager for new revenue

says Libby Beaty, executive director of the National Association of Telecommunications Officers & Advisors, which represents 1,100 cities. "If they violate the [Telecommunications] Act, they are going to land in court."

What makes the issue particularly thorny for the telcos is that unless the FCC weighs in on the issue in their favor, they must deal individually with hundreds, perhaps thousands, of separate communities. Dearborn, Mich., typifies the troubles SBC and Verizon face. If SBC's video rollout reaches this suburb of Detroit, it will run into Mayor Michael A. Guido. The local chief, who also heads the U.S. Conference of Mayors' task force on telecommunications, expects SBC to secure a local franchise, pay fees, and offer service to all Dearborn residents, regardless of their spending habits. Those were the terms for the current cable providers, he says, and they won't be different for SBC. "We'll say welcome," says Guido, "but we will tell them they have to follow the same rules."

Absent a fast rewrite of federal law, the crazy quilt of local franchises is likely to muffle the Baby Bells' video plans and keep them fighting with city officials for some time to come. ■

—By Brian Grow in Atlanta and Roger O. Crockett in Chicago, with Cathy Yang in Washington, D.C.

EMPLOYMENT

FOR 2005 GRADS, JOB OFFERS ARE ROLLING IN

After three slack years, employers across a range of industries have headed back to campus

WHEN KATHERINE HO returned for her senior year at the University of Michigan in August, she was busy with more than classwork. Within weeks the 21-year-old mechanical-engineering major had plunged into a whirlwind of on-campus job interviews with nearly a dozen companies, from Boeing to General Electric to DuPont. By early September she had her first job offer—and earlier this month she settled on another, accepting a spot at GE Aircraft Engines. Many of her friends already have offers, too. Having watched the Class of 2004 struggle to find work, Ho was plenty relieved. "It was easier to get interviews," she says. "And I was surprised there were more job openings—it was definitely hard last year."

After three years in which many college grads found jobs scarce, the picture seems to be brightening for next spring's 1 million-plus grads. A study of 582 companies conducted by Collegiate Employment Research Institute at Michigan State University showed that companies plan to expand hiring of grads by 20% over last year; better yet, average pay could rise 4% to 7%. And the change appears to be across the board: Industries ranging from investment banking and health care to retail and real estate say they'll recruit more heavily on campus this year.

Of course, that 20% surge looks particularly good when compared with the dismal performance of recent years. College hiring last spring was up only about 5%, according to the Michigan State survey. In 2003 job growth was flat—follow-

ing a combined 50% contraction for the two previous academic years. "We're not back to the dot-com era," says Lori Meerdink, assistant dean for business career services at University of Illinois at Urbana-Champaign. "But the trend is definitely heading up."

PENT-UP DEMAND

WHY IS CORPORATE America back on campus? Forecasts for continued solid economic growth account for some of the gains; just as important, many companies can no longer continue to put off hiring for jobs left empty through attrition. Add to that the expectation that Baby Boomers will start retiring in a few years, says Phil Gardner, author of the Michigan State survey, and companies have "a human resources gap to fill." What's more, sectors such as consulting and investment banking figure business will pick up in 2005.

Investment banks are recruiting aggressively. Goldman, Sachs & Co. plans to hire about 1,100 grads this year. That's a fraction of the level at the peak of the bull market in 2000, but it's up a fifth from last year. Like other investment banks, Goldman is moving early to get the best talent. Aaron Marcus, its director of campus recruiting for the Americas, says Goldman finished interviewing seniors in October and made most offers within a week or two of the first meeting.

It's too early for undergrads to breathe easy, though. If the economy slows in coming months, recruiters could vanish once again. Still, for Katherine Ho and many other students with jobs waiting for them, this is the best news in a while. ■

—By Jennifer Merritt in New York



IN DEMAND Senior Ho had her first offer by late September

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COMMENTARY

BY AMY BORRUS

No More Breaks for the Big Board

Why the SEC should stand by its plan to loosen the NYSE's hold on trading

FOR MONTHS the Securities & Exchange Commission has held the New York Stock Exchange's feet to the fire. The SEC's agenda: force the Big Board to lower the barriers to competition from rival electronic markets—without undermining the nation's premier financial market. NYSE Chief Executive John A. Thain has responded with plans to beef up the New

York market's puny e-trading system. But the SEC believes those plans aren't adequate—and the agency is now countering with a proposal to turbocharge the automatic matching of buy and sell orders in ways that would force New York to go much further.

At issue is a basic change in how stocks are traded. For years, big investors such as mutual and pension funds have complained that the Big Board uses the so-called trade-through rule to stymie their trading. The rule's purpose is to ensure that investors get the best price available on all markets for stock they buy and sell. Frequently, the NYSE shows the best price. But too often, institutional investors argue, the slow pace of the NYSE's open-outcry auctions means that the displayed price is gone by the time an order actually gets to the exchange. The institutions miss out on the best price—and can't send their order to a competing market that could fill it at a slightly inferior price, but at lightning speed.

The SEC is due to vote on Dec. 15 on a final staff plan. Some big investors want the SEC to scrap the trade-through rule and let them complete trades in whichever market they choose. But Chairman William H. Donaldson, a former NYSE chief, believes investors should always get a shot at the best price. So he's pushing the Big Board to expand its limited system for matching buyers and sellers automatically. Thain has proposed that when the NYSE has the best price, it fill the order with whatever shares are available at that price. If the order is too big to fill, the NYSE will provide shares available on the exchange at next-best prices.

Some large investors are skeptical. Under the NYSE plan, the exchange might capture a 10,000-share order to buy a \$20 stock by offering 1,000 shares at



the best price, \$20. The entire order would be traded at the NYSE, and the average price on the remaining 9,000 shares might be \$20.05. But a rival electronic market might have 9,000 shares to sell at an average of \$20.02. "Protecting only the best price is meaningless," argues John J. Wheeler, director of U.S. equity trading for American Century Investments in Kansas City, Mo.

Nor does the NYSE's winner-take-all plan sit well with the SEC. Instead, the agency is floating the idea of an "intermarket sweep." On a \$20 buy order, the market that offers 1,000 shares at \$20 would still get the first crack. But the remaining 9,000 shares would be routed to whichever markets offer the second best price—and so on until the order is filled. The result: a fair trade at the lowest average price. Institutions would get their orders filled before other traders noticed and bid against them. Individuals would be able to place "limit orders"—orders to buy or sell at a specified price—without fearing their order would be bypassed, making their trades cheaper.

But that doesn't go far enough for some big players. "We don't think the government should be deciding for investors where they should send their orders," says Eric D. Roiter, senior vice-president at Fidelity Management & Research Co. The Big Board also faces a thornier dilemma. The rise of electronic trading could squeeze the livelihoods of 400 or so independent floor brokers. That has some floor brokers griping that the SEC is trying to push through a radical rule change without seeking public comment. But the agency has repeatedly fine-tuned its original rule proposal, first unveiled back in February.

Guaranteeing that orders get filled with the best prices displayed would be a tectonic shift in trading rules. That's why the SEC shouldn't let the Big Board get by with half a reform—a system that preserves its 80% lock on trading in listed stocks. To get investors the best prices, the SEC needs to make a clear sweep of barriers that impede trading. ■

THE STAT

80%

Share of trading in NYSE-listed stocks that flows through the Big Board

Data: SEC, NYSE, and E*Trade

THE GLENLIVE

(OR AS IT CAME TO BE KNOWN)

THE SINGLE MALT *that* STARTED

When GEORGE SMITH
founded THE GLENLIVE
in 1824, his SINGLE
MALT WHISKY reflected his



CONVICTION that the
BEST WOULD BE
acclaimed at the time
GUARANTEED

SINGLE MALT SCOTCH WHISKY



The single malt that started it all.



CONSUMER ELECTRONICS

TEXAS INSTRUMENTS INSIDE?

Its Intel-like strategy: Get consumers to seek its chip technology in flat-screen TVs

BACK IN 1982, TEXAS INSTRUMENTS Inc. had one of the hottest brands in tech-dom. Its digital watches and calculators were everywhere, as were its ads with TV icon Bill Cosby promoting its home computers. But when its PC business folded in 1984, so did TI's last attempts at mass marketing.

Now that's changing. In November, TI launched a major marketing blitz aimed at reintroducing itself to consumers while spurring sales of flat-screen TVs that use its digital light-processing chips. In TV spots that will air during peak viewing times, including the Super Bowl on Feb. 6, TI is promoting the picture quality of sets that use DLP, a proprietary technology that involves bouncing light off more than a million tiny mirrors. If the ads are a success, consumers could see TI start to position itself as a hip, innovative company behind a range of consumer products. "We're in an era where communications and consumer electronics are the most important [markets]," says Richard K. Templeton, who became CEO in May.

TI is taking a page from the famous "Intel Inside" ad campaign—but success is not guaranteed. That campaign helped establish Intel Corp. as a brand consumers seek out when shopping for what was

then a complicated and relatively new market for PCs. Intel also gave hundreds of millions of dollars in marketing funds to PC makers that used its chips. Many depended heavily on Intel, boosting its influence in the market. But TI isn't spreading marketing largesse; moreover, it's loath to risk alienating the manufacturers that buy its chips by doing anything that could undermine their brands.

Still, TI is eager to establish itself in consumer electronics. As home entertainment goes digital, it's looking more like PCs, where manufacturers' brands have less sway over buyers than those of Intel and Microsoft Corp. "People are starting to look at what the components are," says researcher NPD Group Inc. analyst Stephen Baker.

That gives TI an opening. When the first TVs based on DLP hit the market in 2002, they quickly took hold as a viable alternative to plasma and liquid-crystal display sets. The latest models are just seven inches thick, making them almost

GET THE PICTURE?
DLP TVs rival LCD or plasma, says TI, but cost far less

as slim and sexy yet they go for about half the price. In September, DLP sets ac-

counted for 28.1% of the big-screen market in North America, neck and neck with plasma and LCD. Sales should reach \$75 million for TI this year, says American Technology Research analyst Erach Desai, up 127%.

PLASMA POWER

WITH THE PEAK TV-buying season approaching, TI and its customers know their growth is vulnerable. Digital-TV sales are expected to rise 70% this year. But with prices falling rapidly, plasma sales soared 58% from August to September compared to 28% for DLP sets, according to NPD. So in addition to its TV advertising, TI is also installing slick in-store displays with retailers such as Best Buy, hoping to promote what they claim is the superior picture quality. One factor in TI's favor: DLP sets typically come in much larger sizes than plasmas, making them a more popular choice for sports nuts and home-theater enthusiasts. The upshot: DLP should continue its strong growth

even if ever-cheaper flat-panel technologies like plasma grab more share. "I think they have an opportunity," says American Technology Research analyst Erach Desai.

A harder task may be establishing TI's brand in other categories. TI is the No. 1 seller of chips for cell phones, supplying the brains of the snazziest multimedia models in the market. But cell-phone makers are unlikely to cede space to handsets for TI's logo. And it's far from clear that buyers would search out the chipmaker in a crowded consumer-electronics market even if they knew who it was. "It's an uphill battle," says Silicon Valley marketing consultant Regis McKenna.

Still, as technologies converge, chip makers are assuming more influence over the design of electronic products. That may help them play a bigger role in marketing, analysts say. TI recently announced plans to add digital TV to cell phones by 2007. If that's not a gizmo for a Super Bowl ad, what is? ■

—By Andrew Park in Dallas



Templeton sees no hotter area than consumer electronics

SOFTWARE

'HE'S GOING TO HAVE HIS HANDS FULL'

CA's new boss has the right credentials. But fixing the software giant won't be easy

AFTER NEARLY THREE years of tumult and uncertainty, Computer Associates International Inc. finally seems to be on the road to stability. On Nov. 23 the board announced it had appointed IBM veteran John Swainson to be its president and CEO-elect.

Swainson, 50, is just what Wall Street ordered. Over the summer, after it seemed that CA's board might make director and interim boss Kenneth Cron its next CEO, analysts warned them off, calling for an outsider with software industry experience. Swainson has plenty of that: In 26 years at IBM he held a wide variety of such jobs, most recently running the software division's sales operations. "This is great for CA. They need somebody who's a proven technologist with impeccable integrity," says Michael Lawrie, chief executive of software maker Siebel Systems Inc. and former head of IBM's worldwide sales.

But it won't be easy for Swainson. He has never run a company as large and complicated as CA, a \$3.5 billion maker of software for computer systems management, security, and storage. Moreover, while CA's business has held up amid a sluggish tech market, growth is weak. Swainson will be under pressure to change that—while also rebuilding credibility with investors and customers wearied by years of accounting scandals. "He knows a lot about software development, but CA is not a development challenge. It's a business challenge," says John R. Patrick, a longtime IBM executive who now runs consultancy Attitude LLC. "He's going to have his hands full."

CA has been a pressure cooker since

SWAINSON
He'll be under pressure to jolt weak growth



Swainson's Checklist

PATCH UP CA's scandal-plagued image with Wall Street and its corporate customers

CONCENTRATE ON developing hits in security, storage, and computer-systems management

REFLECTS acquisition strategy away from big deals, buying small outfits with growth potential instead

February, 2002, when the company revealed a Justice Dept. accounting probe. A total of 15 executives and other employees have left since last October in connection with the investigation, which culminated with the December indictment of former CEO Stephen J. Lerner. He was charged with securities fraud and obstruction of justice but pleaded not guilty. At the same time, CA settled, agreeing to pay \$225 million into a restitution fund for shareholders.

CA plans to let Swainson acclimate

gradually. He'll be president in charge of software strategy for four to six months before he takes over the CEO spot. In the meantime, Cron will remain at the helm. "We wanted to give John the best chance to succeed," says CA Chairman Lewis S. Ranieri. "It seemed like a good opportunity for John to get his arms around the software strategy and ease him into the big job."

AN UNDERSTUDY?

THE UNUSUAL CEO-in-waiting arrangement could prove to be awkward, though. That's because Cron, who was appointed interim CEO last April, wanted to keep the job, and it might be difficult for him to give up control. In addition, according to Jeffrey A. Sonnenfeld, a professor at the Yale School of Management, the tactic seems to show a lack of confidence in Swainson's ability to lead. "This guy comes in as an understudy," says Sonnenfeld. "It delays the taking charge process."

Swainson is quick to dismiss such concerns. Though he has never overseen broader corporate areas such as finance, he ran a large product group. "For seven years I ran a bigger operation than CA," he says, referring to IBM's \$1 billion middleware business. He has firm ideas about CA's future. No longer will it be primarily an acquirer of other companies. Swainson plans on spotting opportunities to fill in gaps in CA's product offerings, either by developing technologies internally or making strategic acquisitions—like the outfit's recent purchase of Web security specialist Netegrity Inc. for \$430 million.

Swainson should have no trouble establishing credibility as a software visionary. IBMers credit him with spotting the potential in an e-commerce program that an engineer had written for the 1996 Olympics and turning it into WebSphere, the company's software for building and integrating corporate applications. Introduced in 1998, WebSphere now represents about \$1 billion in revenues and is the linchpin of IBM's software strategy. To get CA surging again, Swainson may have to produce another such miracle.

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—By Steve Hamm in New York

It's not just your name on the line.

X

Chief Executive Officer

X

Chief Financial Officer

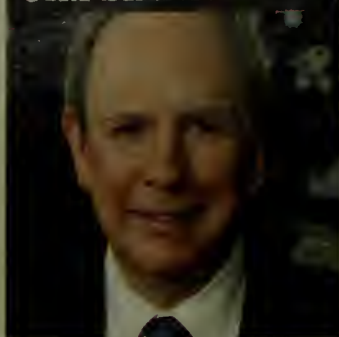
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EDITED BY MONICA GAGNIER

HEADLINER

JIM SKINNER



NOW IT'S HIS SHIFT

For the second time in just seven months, McDonald's has hastily elevated an heir apparent to chief executive. Vice-Chairman James Skinner, effectively the fast-food giant's chief operating officer, was promoted to CEO on Nov. 22. He replaces Charles Bell, who resigned to focus on his battle with colon cancer. Bell, 44, became CEO in April, when predecessor James Cantalupo died after only 16 months at the helm.

Skinner's challenges are twofold: He must maintain momentum at Big Mac, which has logged 19 months in a row of sales gains, thanks to an improved menu and better service. And he must buck up the morale of McDonald's stunned employees and franchisees.

He should be able to pull it off. Skinner, 60, who started with McDonald's in 1971 as a restaurant manager trainee, had been running the company from behind the scenes this fall as Bell's health deteriorated. He will also get a hand from heir apparent Michael Roberts, whom McDonald's promoted to COO from U.S. president.

—Michael Arndt

AIG SETTLES THE TAB

American International Group on Nov. 23 said it has agreed in principle to settle Securities & Exchange Commission and Justice Dept. charges that it helped PNC Financial Services and telecom supplier Brightpoint mislead investors. Without admitting or denying guilt, the insurer agreed to pay more than \$100 million in penalties, according to a source close to the probe. AIG also said it will allow an outside monitor to review its contracts to see if it sold policies to help other companies hide debt or smooth earnings. AIG previously paid \$10 million to settle SEC charges of selling allegedly fake insurance policies to hide losses at Brightpoint. The PNC and Brightpoint deals triggered a criminal probe by Justice, but it will probably be dropped unless further evidence of alleged wrongdoing emerges.

KRISPY GETS KREMED



Krispy Kreme Doughnuts is coming down from its sugar high. The Winston-Salem (N.C.)-based doughnut chain lost \$3 million in the quarter ended on Oct. 31, vs. a \$14.5 million gain in the same period in 2003. The news sent its stock down 16% on

Nov. 22, to \$9.64, 91% below its all-time high in 2000. While Krispy Kreme CEO Scott Livengood blamed the loss on the low-carb craze, rival Dunkin' Donuts hasn't seen a similar fall. Instead, analysts believe Krispy Kreme overexpanded in some key markets, cannibalizing older stores. Krispy Kreme executives believe they can get back in the black by rolling out sugar-free doughnuts and focusing on smaller stores that cost less to build and staff.

MUSIC TO APPLE'S EARS

It seems Apple Computer's iPod music player may be doing what years of marketing have been unable to do: persuade PC owners to jump to the Mac. On Nov. 22, Piper Jaffray put out a report suggesting that 700,000 or so iPod lovers either have or plan to buy a Mac in the next year, and that 1.2 million more will do so in 2006. The report, which set a target price of \$100, sent Apple shares up 11%, to \$61.35—a four-year-high. But don't look for Apple to make a serious run at Microsoft's PC market share. Even with new buyers, Apple will still have less than 3% of the PC market, says Piper Jaffray.

NIKE: OFFBEAT CASTING

Phil Knight, the 66-year-old co-founder of Nike, raised eyebrows on Nov. 18 when he named William Perez, CEO of S.C. Johnson & Son, to succeed him as president and CEO of the athletic shoe empire. At first blush, Perez seems like an odd fit. But his experience developing new international markets as well as managing a portfolio of consumer

brands such as Windex and Raid bug spray will help Nike. At household-products maker Johnson, Perez succeeded founder Sam Johnson. Understanding the concerns of an entrepreneur should help him get along with Knight, who remains chairman.

ET CETERA...

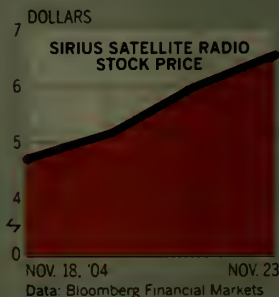
»» Cingular Wireless will cut about 10% of 68,000 jobs as it combines with AT&T Wireless.

»» GE Commercial Finance is paying \$4.4 billion for Citigroup's Transportation Financial Services Group.

»» Fox will broadcast the Fiesta, Orange, and Sugar Bowls when ABC's contract runs out in 2006.

CLOSING BELL

Shares of SIRIUS Satellite Radio have been heading skyward. They rose 12.4% on Nov. 23, to \$6.71, after the company's subscriber count hit 800,000. The stock has climbed 42% since former Viacom President Mel Karmazin was named CEO on Nov. 18.





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BY RICHARD S. DUNHAM

The Democrats Go Scouting for a Savior

WIN AND THE WORLD SMILES with you. Lose in politics, and you're a bum. So it's no wonder that the loudest Bronx cheer in Washington goes to lame-duck Democratic National Committee Chairman Terry McAuliffe, who has presided over two disastrous election setbacks in 24 months. "Terry McAuliffe proved that

raising money isn't enough," says Democratic moneyman Andrew S. Rappaport, a general partner at August Capital Associates LP in Menlo Park, Calif. "[He] is the person who is most responsible for the predicament the Democrats are in."

That may be a bit hyperbolic, but as the Dems try to pick up the pieces after a shattering election, they're looking to replace McAuliffe in February with a party boss who not only talks a big game but actually delivers. Indeed, the crowded campaign for DNC chief is fast becoming a battle for the future direction of the party—not to mention a possible early test for putative 2008 presidential front-runner Hillary Clinton.

■ If the party wants bash-Bush, man-the-barricades liberalism mixed with the latest in internet-fueled fundraising and organizing, it can tie its fortunes to former Vermont Governor Howard Dean.

■ If it seeks a hard-charging centrist who reaches out to swing voters, including the growing Latino population, it can embrace Simon B. Rosenberg, founder of the New Democrat Network.

■ If the party wants its chair to raise wads of money and build bridges to business, it has a contender in longtime telecom exec Leo J. Hindery Jr.

■ If Dems want to emphasize minority candidates who won big in "red" states, it could turn to ex-mayors Wellington E. Webb of Denver or Ron Kirk of Dallas.

■ And if the party is convinced that only the Clintons can save it, the man for the job could well be former Bill and Hill consigliere Harold Ickes.

In practice, the DNC contest is usually decided by state party chairs, who are scheduled to meet on Dec. 4 in Orlando. "They literally have the power to deliver the chairmanship, but they don't have a candidate," says Clinton-era DNC head Joe Andrew, an ex-Indiana party chair.

The candidates have wildly different appeal. Dean is favored by insurgents who want to clean house. "It's time to do some risk-taking," says former party chair Steven Grossman, CEO of MassEnvelope-Plus in Somerville, Mass. But the Clintonistas will only allow such a takeover "over their dead bodies," says one DNC veteran.

Ickes, a driving force in the 527 committees that proliferated in this election, is often seen as a stalking-horse for his close friend Senator Clinton. That could be a problem for those who want a party-builder.

For Democrats who long to see the DNC run more like a business, there's Hindery, an ex-Tele-Communications Inc. president

and AT&T Broadband & Internet Services CEO. But some worry about Hindery's later tenure at scandal-plagued Global Crossing Ltd., a company to which McAuliffe also had connections.

A dark horse is the relentlessly disciplined Rosenberg, who has worked for a decade to steer the party toward the center while building a new generation of tech-savvy activists. "The world has changed," says Rosenberg. "We need a new strategy to take on modern conservatives." One veteran activist says Rosenberg, a fave of Demo-bloggers, starts out as "everybody's second choice" and could eventually win if no other contender catches fire. ■



WHY ARE THESE MEN SMILING? Hindery and Rosenberg

CAPITAL WRAPUP

ANOTHER VACANCY, ANOTHER LOYALIST?

THE REMAKING of the Bush economic team continues.

Stephen Friedman, who heads the National Economic Council, is resigning, White House aides say. Friedman, who has served as a behind-the-scenes policy coordinator, was a co-chair of Goldman Sachs & Co. before he joined the Bush team in December, 2002. While Bush had not named a replacement by the time *BusinessWeek* went to press, the inside track belongs to **Tim Adams**, a former top Treasury aide who served as policy director of the President's reelection campaign.

Adams, a low-key policy expert, would fit the recent Bush pattern: choosing long-time loyalists to fill sensitive posts. Adams is unlikely to bring his own agenda to the job.

PAYING FOR A SOCIAL SECURITY SHIFT

CONGRESSIONAL Republicans are united behind Social Security private accounts—a key plank in **President Bush's** second-term platform. But a major struggle is breaking out over how to pay for the transition to a system that allows workers to divert part of their payroll tax into their own accounts. House Republicans would pay for the shift—which could cost \$1 trillion to \$2 trillion—either by borrowing the funds or by cutting other spending. But **Senator Lindsey Graham (R-S.C.)** says he would even be willing to back tax hikes for individuals or corporations to fund the transition and woo Dems. "If we are not able to attract some Democratic support, this isn't going anywhere," Graham says. The White House has not yet said how it would pay for the transition.

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4

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WHY CONSUMERS HATE MERGERS

A study commissioned by *BusinessWeek* shows it can take companies years to turn bad feelings—and profits—around

BY EMILY THORNTON

RENEE ROBERTS OF ANTELOPE, CALIF., STILL GETS STEAMED

when she thinks about what happened to her after Comcast bought AT&T Broadband for more than \$50 billion two years ago. She says the company lost her \$155 payment in its newly integrated automated system—and then brushed her off. “No one cared,” Roberts complains. “The attitude was ‘we’re big, so you have to deal with us.’” Comcast concedes that it made some billing mistakes after the merger. Last year, to put matters right and fend off competition from satellite-TV operators, it instituted a program to train employees to “Think Customer First.” Now, it says, customer satisfaction scores are back to where they were before the merger. But Roberts is long gone. She gets satellite service with a dish instead.

Mergers often make customers dissatisfied. And once that happens, it can take managers years to regain lost ground. That’s the conclusion of an exclusive analysis done for *BusinessWeek*. The data, which was collected over five years as part of the widely respected American Customer Satisfaction Index, reports on customers’ perceptions of 28 big companies that were involved in major mergers between 1997 and 2002. It showed that customers were significantly less satisfied on average even two years after the deals closed than they were before.

Customers’ satisfaction scores were based on their perceptions of companies’ prices, quality, and ability to meet expectations. In an eye-opening 50% of the deals, consumers gave the compa-

ny lower marks in at least one of the three categories. Customers thought they got better service or prices from only 29% of mergers. Says Claes Fornell, who heads the index for the University of Michigan’s Stephen M. Ross School of Business and the American Society for Quality: “Customers are increasingly frustrated because they perceive they have a lack of choice.”

The frustration is sharpest with mergers in industries whose services have the most direct influence on the quality of Americans’ daily lives. Oil companies, cable-TV outfits, and retail stores saw their satisfaction ratings plunge between 5.3% and 7.4% on average (table, page 63). And the effects can prove to be long-lasting. Five years after SBC Communications Inc. bought Ameritech Corp. for \$70 billion in 1999, its customers

still say they are less satisfied than they were before the merger. The company says its own surveys show the quality of service is now better than it was before the deal.

The monetary cost to individual consumers of service perceived to be worse may seem small, but it soon adds up. Maritz Research Inc. estimates that more than half of the nation’s 109 million households have gone through a bank merger since 1999. Some recent bank deals scored better in terms of customers satisfaction. Still, if one person from each household spent a minute at work asking a bank how its deal would affect them, and was paid for that minute at current average wages, the cost of the time would be \$900 million.

Many people do much more than complain. I

THE STAT

50%

of consumers say they’re less satisfied with companies’ service two years after a merger

Data: University of Michigan Business School



"NO ONE CARED"
Roberts dumped
Comcast after
it lost her \$155
payment

They don't like a merger, they vote with their feet—laying extra costs on companies and potential losses on their investors. New York-based researcher Millionaire Insight Programs estimates that about one-quarter of people with \$1 million or more in investable assets get so upset that they take money out of their accounts soon after their bank merges. Investors seduced by the prospect of higher earnings find many mergers don't deliver promised synergies because factors such as aggressive cost-cutting or mismanagement turn off customers.

Now consumers are facing a new wave of mergers—and possible disappointments. Kmart Corp.'s takeover of Sears, Roebuck & Co. may portend more deals that could engulf a whole range of industries suffering from chronic overcapacity, such as financial services and long-distance phone services. Researcher Thomson Financial estimates that 10% more deals will happen this year than in 2003. Dealmaking, according to Thomson, may reach the highest number in three years and could accelerate even faster next year.

Some companies learned their lessons during the last merger boom. When struggling Qwest Communications International Inc. spent \$56 billion in 2000 to buy a poorer-performing local phone service, US West Inc.—industry wags dubbed it “US Worst”—Qwest's residential consumers felt they paid more for service that they perceived as 12.5% worse. During those two years Qwest upgraded its network and concentrated on serving corporate clients. It took a new CEO and two more years for the company to restore consumer satisfaction to premerger levels. Qwest did that by extending the hours of operation at its call centers and simplifying its bills so that people would know

what they were paying for. Qwest's vice-president of marketing, Mark Pitchford, acknowledged the problems, adding: “A lot of work was needed to get us back to where we were serving our customers the way we should be.”

Logistical Challenge

OTHER COMPANIES also discovered how badly customers reacted to cost-cutting. After their mergers, Exxon Mobil Corp. and BP PLC closed or cut back investing in gas stations. Not surprisingly, customer satisfaction plummeted sharply in both cases. They and the companies they acquired all had customer-satisfaction ratings far above the industry average before their deals and the same or only slightly more afterward. According to our study, BP customers felt that they got 13% less value for their money in terms of the price and quality of service two years after the company's \$55 billion merger with Amoco. ExxonMobil customers felt they got 14% less value for their money and that service dropped in quality by 5%. BP says that five years after its 1998 merger, customers are more satisfied with service at its 15,000 gas stations than before. In the past four years, BP spent \$513 million to brighten up the looks of its stations and added features such as premium coffee shops. “It takes tremendous logistical effort to re-clad and re-logo a retail site network like that,” says BP spokesman Scott D. Dean. ExxonMobil disagrees with the study's findings and says its own surveys show customer satisfaction never declined.

Cable companies, which consumers seem to love to hate,

The Corporation Quality



BIG DEAL

Most high-profile mergers left consumers feeling dissatisfied two years after they happened...

BUYER	TARGET	CHANGE IN CUSTOMER SATISFACTION		COMPANY RESPONSE
		BUYER	INDUSTRY	
Charter Comms	AT&T Broadband Assets	-12.7%	-4.7%	Does its best to satisfy customers
Qwest	US West	-12.5	-1.4	Dramatically improved its service last year
BP	Amoco	-8.4	-3.8	Company surveys show customer satisfaction is now higher than before the merger
First Union	Core States	-8.1	-2.8	Paid high premium and moved too quickly to consolidate operations
SBC	Ameritech	-7	-4.1	Company surveys show quality of service is better than before the merger
Dillards	Mercantile Stores	-6.8	0	Declined to comment
Exxon	Mobil	-6.3	-3.8	Company surveys do not show a decline in customer satisfaction
Bank One	First Chicago	-5.7	-2.8	Operations were not integrated for years and branches were closed
Worldcom	MCI	-5.4	-4	Almost every carrier had a merger that affected customer service
J.C. Penney	Eckerd	-3.8	-1.4	Diverted focus from fixing department stores; failed to dominate drug retailing
AT&T	Tele-Communications	-2.7	-4.1	Declined to comment; sold the assets
Kroger	Fred Meyer	-2.7	0	Success overall; understand must satisfy customers every time they shop
Unilever	Best Foods	-2.4	-2.4	Declined to comment
Kraft*	Nabisco	-1.2	-1.2	Declined to comment

...while a few created better feelings

First Union	Wachovia	+10.6	+5.6	Focused on retaining customers and took more time to integrate
Nestlé	Ralston Purina	+3.7	+1.2	Quickly introduced new and improved products
Bell Atlantic	NYNEX	+1.4	-3.9	Bell Atlantic took advantage of the best practices and people
General Mills	Pillsbury	+1.2	-1.2	Quickly extended PR push for Pillsbury lines

*Kraft is 85% owned by Altria which merged Nabisco into it

Data: University of Michigan Customer Satisfaction Index; Thomson Financial Corp. Companies

appear especially adept at alienating them after mergers. Consider Comcast Corp., one of our study's worst-scoring companies in terms of customer satisfaction along with rival operator Charter Communications Inc. Comcast has been willing to take a chance on more complaints about poor service as they quickly upgraded the networks of the customers it acquires. That's because it can then offer improved features such as video on demand and high-definition TV. "We'd rather risk moving faster on the rebuild side because we know at the end we'll have a more competitive product," says Dave Watson, Comcast's executive vice-president of operations.

But absent effective remedial action when ratings slide, customers can stay mad for long periods. In 2003, two years after Charter paid \$1.8 billion for cable systems from AT&T Broadband, customers still reported the quality of service was 12.7% worse—the biggest drop among the 28 major deals

studied. Charter points out that it hasn't done any major deal since then and says it tracks customer satisfaction on a frequent basis and does its "best to keep them satisfied."

Dissatisfaction Guaranteed?

IN MANY DEALS, A SLUMP in consumer satisfaction seems to be almost cooked in. Often, the data shows, takeover targets have a worse record than acquirers, whose own ratings are subsequently dragged down. That may be one reason why Hewlett-Packard Co., which paid \$19 billion for Compaq in 2002 in the hope of leaping ahead of competitors in the retail PC business, is still struggling to keep up with market leader Dell Inc., which has never made a major acquisition. When HP bought Compaq, our study reveals, customers were less satis-

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Patient Information about VYTORIN (VI-tor-in)
Generic name: ezetimibe/simvastatin tablets

Read this information carefully before you start taking VYTORIN. Review this information each time you refill your prescription for VYTORIN as there may be new information. This information does not take the place of talking with your doctor about your medical condition or your treatment. If you have any questions about VYTORIN, ask your doctor. Only your doctor can determine if VYTORIN is right for you.

What is VYTORIN?

VYTORIN is a medicine used to lower levels of total cholesterol, LDL (bad) cholesterol, and fatty substances called triglycerides in the blood. In addition, VYTORIN raises levels of HDL (good) cholesterol. It is used for patients who cannot control their cholesterol levels by diet alone. You should stay on a cholesterol-lowering diet while taking this medicine.

VYTORIN works to reduce your cholesterol in two ways. It reduces the cholesterol absorbed in your digestive tract, as well as the cholesterol your body makes by itself. VYTORIN does not help you lose weight.

Who should not take VYTORIN?

Do not take VYTORIN:

- If you are allergic to ezetimibe or simvastatin, the active ingredients in VYTORIN, or to the inactive ingredients. For a list of inactive ingredients, see the "Inactive ingredients" section at the end of this information sheet.
- If you have active liver disease or repeated blood tests indicating possible liver problems.
- If you are pregnant, or think you may be pregnant, or planning to become pregnant or breast-feeding.

VYTORIN is not recommended for use in children under 10 years of age.

What should I tell my doctor before and while taking VYTORIN?

Tell your doctor right away if you experience unexplained muscle pain, tenderness, or weakness. This is because on rare occasions, muscle problems can be serious, including muscle breakdown resulting in kidney damage.

The risk of muscle breakdown is greater at higher doses of VYTORIN.

The risk of muscle breakdown is greater in patients with kidney problems.

Taking VYTORIN with certain substances can increase the risk of muscle problems. It is particularly important to tell your doctor if you are taking any of the following:

- cyclosporine

- antifungal agents (such as itraconazole or ketoconazole)
- fibric acid derivatives (such as gemfibrozil, bezafibrate, or fenofibrate)
- the antibiotics erythromycin and clarithromycin
- HIV protease inhibitors (such as indinavir, nelfinavir, ritonavir, and saquinavir)
- the antidepressant nefazodone
- amiodarone (a drug used to treat an irregular heartbeat)
- verapamil (a drug used to treat high blood pressure, chest pain associated with heart disease, or other heart conditions)
- large doses (≥ 1 g/day) of niacin or nicotinic acid
- large quantities of grapefruit juice (>1 quart daily)

It is also important to tell your doctor if you are taking coumarin anticoagulants (drugs that prevent blood clots, such as warfarin).

Tell your doctor about any prescription and nonprescription medicines you are taking or plan to take, including natural or herbal remedies.

Tell your doctor about all your medical conditions including allergies.

Tell your doctor if you:

- drink substantial quantities of alcohol or ever had liver problems. VYTORIN may not be right for you.
- are pregnant or plan to become pregnant. Do not use VYTORIN if you are pregnant, trying to become pregnant or suspect that you are pregnant. If you become pregnant while taking VYTORIN, stop taking it and contact your doctor immediately.
- are breast-feeding. Do not use VYTORIN if you are breast-feeding.

Tell other doctors prescribing a new medication that you are taking VYTORIN.

How should I take VYTORIN?

- Take VYTORIN once a day, in the evening, with or without food.
- Try to take VYTORIN as prescribed. If you miss a dose, do not take an extra dose. Just resume your usual schedule.
- Continue to follow a cholesterol-lowering diet while taking VYTORIN. Ask your doctor if you need diet information.
- Keep taking VYTORIN unless your doctor tells you to stop. If you stop taking VYTORIN, your cholesterol may rise again.

What should I do in case of an overdose?

Contact your doctor immediately.

What are the possible side effects of VYTORIN?

See your doctor regularly to check your cholesterol level and to check for side effects. Your doctor may do blood tests to check your liver before you start taking VYTORIN and during treatment.

In clinical studies patients reported the following common side effects while taking VYTORIN: headache and muscle pain (see What should I tell my doctor before and while taking VYTORIN?).

The following side effects have been reported in general use with either ezetimibe or simvastatin tablets (tablets that contain the active ingredients of VYTORIN):

- allergic reactions including swelling of the face, lips, tongue, and/or throat that may cause difficulty in breathing or swallowing (which may require treatment right away), and rash; inflammation of the pancreas; nausea; gallstones; inflammation of the gallbladder.

Tell your doctor if you are having these or any other medical problems while on VYTORIN. This is not a complete list of side effects. For a complete list, ask your doctor or pharmacist.

General Information about VYTORIN

Medicines are sometimes prescribed for conditions that are not mentioned in patient information leaflets. Do not use VYTORIN for a condition for which it was not prescribed. Do not give VYTORIN to other people, even if they have the same condition you have. It may harm them.

This summarizes the most important information about VYTORIN. If you would like more information, talk with your doctor. You can ask your pharmacist or doctor for information about VYTORIN that is written for health professionals. For additional information, visit the following web site: vytorin.com.

Inactive ingredients:

Butylated hydroxyanisole NF, citric acid monohydrate USP, croscarmellose sodium NF, hydroxypropyl methylcellulose USP, lactose monohydrate NF, magnesium stearate NF, microcrystalline cellulose NF, and propyl gallate NF.

Issued July 2004



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By:
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Singapore 637766

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The Corporation

MERGER HOOPLA: BP

Execs celebrating the deal before consumers grew unhappy

ed with Compaq than either HP or Dell by a wide margin. Although HP says its own studies over the last 12 months indicate increasing customer satisfaction, the data suggest the deal didn't make customers much more satisfied. Meanwhile, Dell's scores rose 3.9%.

Of course, some companies manage to pull mergers off better than others do. For example, Bell Atlantic Corp. phased in changes in its billing and order-taking systems slowly when it bought NYNEX and then GTE to form Verizon Communications in 2000. And it was cautious about trying to upgrade its network at the same time. Bell Atlantic's reward: Customer satisfaction held steady after both deals despite a fall in the average rating of telecom companies. "You can talk a lot about new technology, but keeping customers is about service," says Paul LaFutture, president of Verizon's network-services group.

Customers also perceived some improvement after the last wave of deals that created several food giants. "It's very easy to forget the consumer during a merger," says Mark Addicks, chief marketing officer at General Mills Inc. But the survey shows customers were more satisfied after it bought crosstown rival Pillsbury Co. in late 2001 for \$10.5 billion, enabling it to offer everything from cereals to Yoplait and Green Giant vegetables. "We were focused from very early on not to miss a beat," says Addicks.

Now food giants are fine-tuning their merger practices to bring benefits to consumers more quickly. After Switzerland's Nestlé bought pet-food maker Ralston Purina Co. in late 2001 for \$10 billion, it revamped canned Alpo dog foods within a year, in part by adding a flip-top lid, a first in large cans. The St. Louis company then refreshed up Friskies cat foods with better ingredients. This year it used more marketing muscle to relaunch Purina Dog Chow. "The consumer is our focus, and we did not want to see that deteriorate," says Terry Lock, president of Nestlé Purina Pet Care's North American division.

Shifting Priorities

SOME BANKS HAVE also learned the hard way that they must invest in consumers if they hope to keep them. In the late 1990s banks cut costs dramatically to make up for high premiums they paid to buy rivals. It was a generally accepted principle that you would lose a double-digit percentage of



your customers," says David M. Carroll, a senior vice-president at Wachovia Corp. However, Wachovia changed its acquisition strategy dramatically once it discovered just how costly it was to lose customers. When First Union Corp. bought Wachovia in 2001 and then took its name, it made customer retention a top priority. "We meted out change at a pace that people could deal with," says Carroll. The result: Wachovia's customer-satisfaction score soared 10.6% two years after the deal.

Bank One has also changed its tune after losing hundreds of thousands of customers in the wake of a major merger. When Bank One, then called Banc One, bought First Chicago NBD Corp., it closed dozens of branches, crimped tellers' ability to solve customers' problems by reducing their responsibilities, and

failed to integrate the two banks' multiple computer systems for years. Consequently, customer satisfaction plummeted 6% almost immediately, according to the study. It took a new CEO, Jamie Dimon, to clean up the mess by taking the opposite approach.

Fast-forward to JPMorgan Chase's deal with Bank One in July: Dimon is taking the same tack. The day the deal closed he melded the banks' ATM systems nationwide so customers could withdraw money and check their balances for free, opened new branches, and started offering Chase mortgages in Bank One branches. As a result, JPMorgan reported 187,000 net new individual accounts in the third quarter. That's a far cry from when Bank One lost 200,000 more accounts than collected in the year 2000 as it struggled to integrate First Chicago, which it had bought years earlier. "We're going to offer improved products and pricing soon," says Charles W. Scharf, head of the JPMorgan's retail financial services.

As corporate execs get the urge to merge again, they need to keep consumers' interests in mind more than they did during the last buying binge in the '90s—for the sake of their customers and their companies' own futures. ■

—With Michael Arndt and Joseph Weber in Chicago

CAN'T GET NO SATISFACTION

Two years after a merger, many customers feel the service they get is worse

INDUSTRY	CHANGE IN AVERAGE CUSTOMER SATISFACTION
Gasoline	-7.4%
Cable	-6.4
Retail	-5.3
Telecoms	-3.7
Personal Care*	-2.4
Banks**	-0.8
Autos	0
Hotels*	0
Computers***	0
Food	+0.9

*One deal

** First Union's purchase of Wachovia increased customer satisfaction by 10.6%

*** Hewlett-Packard's purchase of Compaq only

Data: University of Michigan American Customer Satisfaction Index



TRANSITION MacMillan (left) will succeed John Brown as chief executive on Jan. 1

Knees and Hips— And Now What?

Stryker may need more than artificial joints. Its CEO-to-be is betting on biotech

WHEN JOHN BROWN, 70, retires as CEO of Stryker Corp. on Jan. 1, he will leave behind a powerhouse company built on weak knees. Over 27 years, Brown racked up average annual earnings growth of 22%. He transformed a \$17 million hospital-bed company into a \$4 billion provider of artificial joints, implants, and surgical instruments. That earned Stryker the No. 30 spot on last spring's BusinessWeek 50—the third year in a row it was recognized as a top-performing company.

With such success, though, come sky-high expectations—and a steep penalty for slipping. On July 15, the Kalamazoo (Mich.) company reported another strong quarter: 42% higher profits. But sales growth, at 17%, was off a bit. Add to that

some lingering nervousness about Brown's looming departure. Many investors, facing a price-earnings ratio of 43 on a stock that had nearly doubled in price in the past 17 months, to \$57, figured it was a good time to cash out. In one day, Stryker's stock price fell \$8.76, or 16%. In October, Stryker again spooked investors when costs from buying a spinal-device company and delays on a new artificial knee drove down third-quarter earnings by 87%. Today, Stryker shares trade near \$44.

The job of filling Brown's shoes—and calming those nervous investors—falls to Stephen P. MacMillan. A former pharmaceuticals executive, MacMillan, 41, is betting he can create a new growth engine through biotechnology. He has high hopes for OP-1, a compound for promot-

ing bone growth that Stryker has been developing for two decades. He also plans to continue Brown's strategy of adding products through judicious acquisitions. "To sustain revenues at the \$4 billion to \$5 billion level, we're going to need more innovation," MacMillan says.

NEW KNEES

ANYWAY YOU slice it, though, Stryker's pace is certain to slow. It already faces heated competition—unlike some health-care sectors that can count on high inflation, orthopedics makers rarely see price increases of more than 3% a year. That puts a heavy premi-

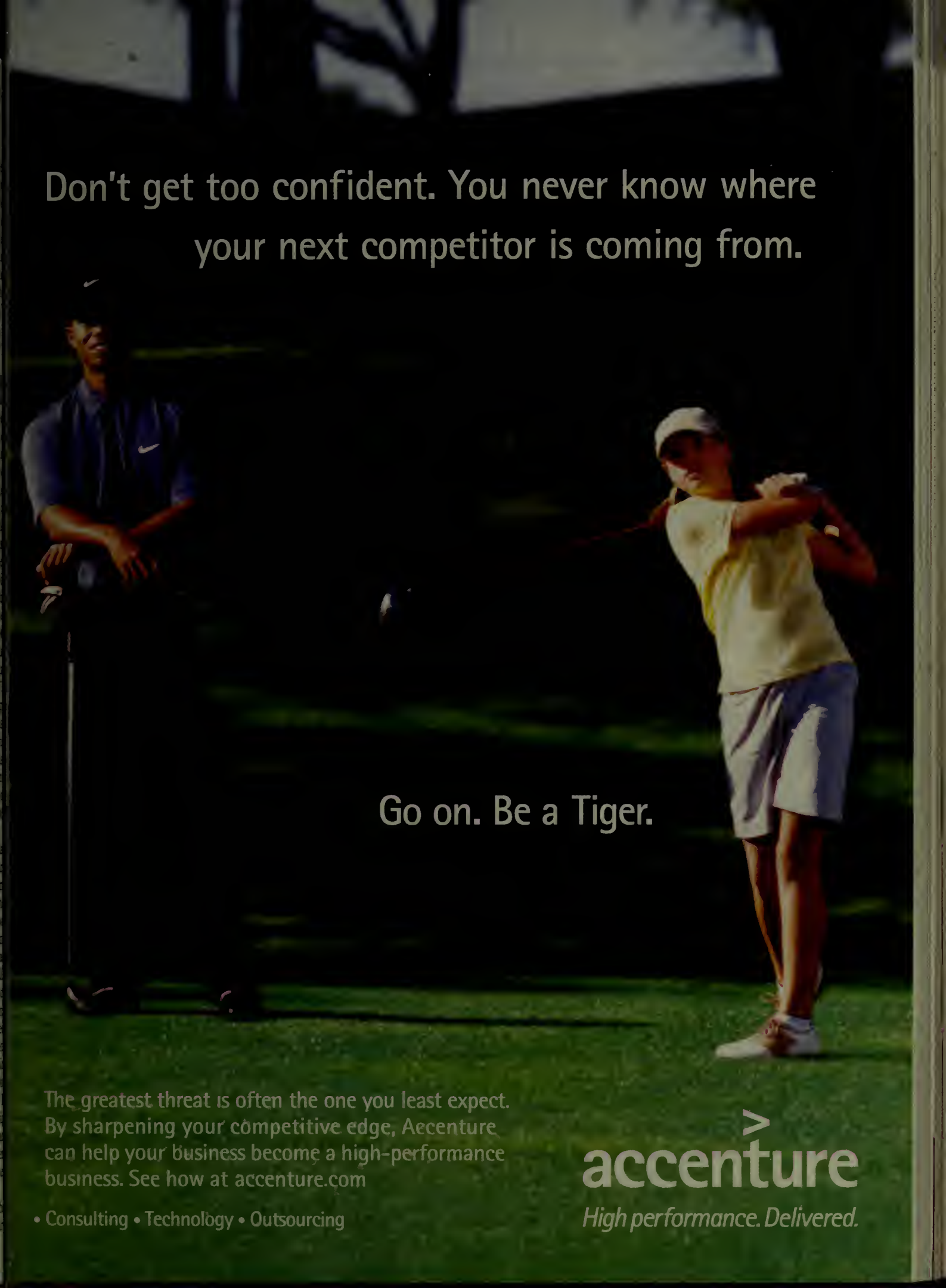
um on coming up with new products. Stryker just launched the Triathlon knee, which is more stable and flexible. And it got a big boost starting in 2003 from its revolutionary Trident hip—a ceramic and titanium joint, priced \$300 to \$400 above previous products, that could double the life of an implant to 30 years. But now rivals such as Johnson & Johnson's DePuy Inc. unit and Zimmer Holding Inc. are piling in with their own versions. Stryker's move into biotech will only increase its exposure to powerful rivals. Earnings this year should still rise 27%, to \$575 million, according to a Thomson First Call survey of analysts. But 2003 growth is expected to slow to 20%.



MacMillan knows what Stryker is up against. He arrived in June, 2003, from Pharmacia Corp., where he turned around a \$2 billion unit that included such underperforming operations as consumer health care and diagnostics. Previously, Mac-

Millan spent most of his career at Johnson & Johnson, where he marketed Tylenol and later ran European marketing. That background should come in handy as Stryker appeals more directly to consumers via newspaper and TV ads. I built a campaign for a new ceramic hip around golfer Jack Nicklaus, who got an artificial hip in 1999. "We haven't been taking full advantage of the Stryker brand," Brown says.

Stryker has come a long way from the company founded by a Kalamazoo sur-

A photograph of Tiger Woods on the left, wearing a blue polo shirt and dark pants, standing with his arms crossed and a slight smile. On the right, a golfer in a white shirt and light blue shorts is captured mid-swing. The background is a blurred green golf course.

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your next competitor is coming from.

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The Corporation

geon in 1941. Dr. Homer Stryker started out selling a bed that made it easier for nurses to turn patients and avoid bedsores. Stryker heirs still hold a controlling 24% stake. Brown, a courtly man with a tinge of his native Tennessee in his voice, was hired in 1977 after the founder's son and presi-

dent, Lee Stryker, died in a plane crash. Two years later, when Brown took Stryker public, bankers told him it would need at least 20% annual earnings gains to be considered a growth stock. Brown got there with a string of savvy acquisitions. The biggest: the \$1.65 billion purchase of Howmedica from Pfizer Inc. in 1998.

As Brown moved into each new area, he gave division heads plenty of autonomy—and incentives. Half to two-thirds of officers' bonuses are tied to their results. "If you don't get your numbers, we may empathize and sympathize—but you don't get paid," he says. The formula paid handsomely for investors, as Stryker stock returned 928% over the past 10 years, vs. 184% for the Standard & Poor's 500-stock index. Brown's own stake is worth about \$800 million.

With rivals piling in, Stryker's sales pace is slowing

To continue that streak, Stryker is counting on aging baby boomers. Their weekend escapades on basketball courts and ski slopes often result in damaged joints. And as Americans become increasingly obese, their weight strains hips and knees. Selling implants to boomers' parents and

grandparents has already won Stryker a 24% share of artificial hips and a 19% share in knees.

Shortly after MacMillan signed on, he and Brown hammered out a transition plan at a pancake house. In 2003, Brown was in charge while MacMillan learned the business. This year, the new guy ran day-to-day operations with Brown's oversight. MacMillan immersed himself in learning the medical-devices business. It hasn't all been lab visits and sales calls. While weighing the purchase of SpineCore Inc., a maker of artificial spinal disks, he donned a surgical mask to observe a trial surgery.

MacMillan cinched that \$120 million deal in July, with Brown's backing. MacMillan calls it a research and development investment—SpineCore's two spine products are still in clinical trials and won't pay off until at least 2008. Stryker's real long-term gamble, though, is OP-1, the growth agent used on traumatic bone breaks that won't heal on their own. Figuring that such substances might one day make current orthopedic implants obsolete, Brown has plowed \$300 million into research since 1985. OP-1 is being used in Europe and Asia. In the U.S., the Food & Drug Administration has approved it for limited "humanitarian" uses while trials continue. For now, Stryker's share of bone-growth agents and spinal products is small. Michael F. DeMane, president of Medtronic Inc.'s spinal products unit—which claims nearly half the market—says Stryker has yet to prove that OP-1 works: "They don't have a product that is a barn burner."

When MacMillan signed up as Brown's successor, he was lured by a lock on the CEO job, of course. But he also has a chance to guide a smaller company to industry leadership. "I look at Stryker as the next J&J," MacMillan says. The trick, he admits, is balancing a vision for Stryker's future while delivering strong profits growth quarter after quarter. Only if he can pull off both will MacMillan deliver on Brown's legacy. ■

—By Kathleen Kerwin in Kalamazoo, Mich., with Michael Arndt in Chicago



IMPLANT
Artificial
hip

Growing Pains

How incoming CEO Stephen MacMillan plans to stoke Stryker's expansion:

- Guide the company's entry into more biotech products; its first, a bone-growth agent, is still a couple of years away
- Selectively buy up more companies, such as recent acquisition SpineCore, that have cutting-edge products
- Beef up Stryker's own R&D division to develop more of those products in house
- Maintain strict attention to financial goals to continue a record of 20%-plus earnings growth

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The Power of Performance Management

The benefits of data analysis are sharply strengthened when teams work together.



Kids Headquarters' explosive growth over the past decade from proprietary apparel and licensed brands like Disney and Nickelodeon has brought a challenge many companies face today: The \$700-million clothing firm couldn't make sense of the huge amount of sales and financial data that

poured in from points as close as Boston and Indiana and as far as Bangkok and Indonesia.

Kevin Downs, Kids Headquarters' chief technology officer, found the company was often generating eight production reports from eight sources and coming up with eight different answers. Sales

assistants would spend days crunching numbers and putting the data into Excel spreadsheets for sales executives. But the data wasn't re-entered into the system and often didn't match the inventory in the warehouse. As a result, the firm's business was driven by gross sales because

there wasn't enough current information to look at the more important figure of gross margins until long after a selling period.

"We were really being hurt by charge-backs," Downs says. "The information wasn't in a readily available form until it was dumped into the ERP (enterprise resource planning) system and a report came out at the end of the month, which was almost like managing after the accident."

But today, that's not the case. The CEO of Kids Headquarters can turn on his computer and colored bars and dials will give him a snapshot of the business at any given point in time. The system

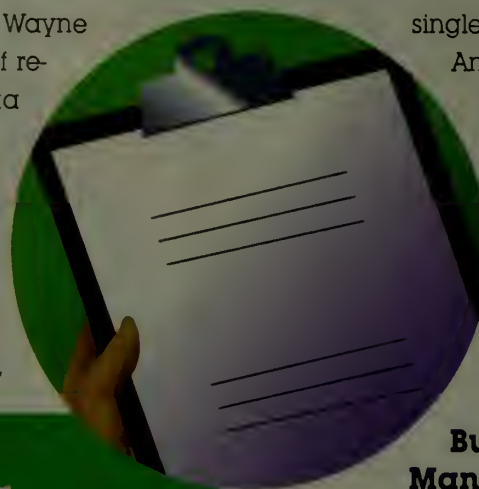
in IT: enterprise performance management (EPM).

At first glance, EPM might seem like just another acronym to describe business intelligence (BI)—the processes and technologies used to turn information into insight and action. Indeed, that is what Wayne Eckerson, director of research at The Data Warehousing Institute, used to believe. What he has come to realize, however, is that BI is actually the enabling technology,

measures that will drive strategic performance without incentivizing some employees to work at cross-purposes with company goals? How can data be pulled together from many groups with different processes and business systems

to deliver the holy grail of "a single version of the truth"?

And, most importantly, as Eckerson points out, how can companies initiate the cultural transformation required to get workers at every level to use the technology?



Business Process Management

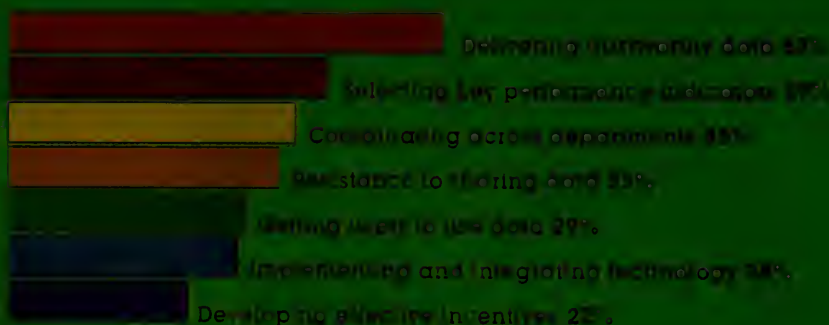
The first step in turbo-charging an enterprise is to make sure business processes are efficient. Business process management is all about removing variability. It combines software, workflow and business rules to improve specific business processes.

As a result, cross-application business processes "may be slow, opaque, inefficient and error prone, yielding high operating costs and decreased customer satisfaction," says Nimish Mehta, group vice president, universal application network at Siebel Systems. Typical integration approaches often result in point solutions that do not fully account for the steps users must take to complete a business process. "Integration remains a CIO's top priority," Mehta says.

Many people, experts say, see BPM as a workflow tool that automates tasks. While that is true, experts say it overlooks the bigger effect on the benchmarking process. Take Dell Computer, which may be the poster child for BPM. When a delivery person finds out a product order can't be delivered for some reason, that information immediately goes back to Dell, which determines what error in the process occurred. Was the

What Slows Down Your Intelligence?

Execs' top data problems



Source: Survey by the Data Warehousing Institute of 140 executives

instantaneously alerts him of any charge-back that doesn't fall within rigorous criteria "Now he can nip the problem in the bud rather than wait until the end of the month and find out our markup has been affected by one-and-a-half percent by the charge-back," Downs says.

The resulting cost savings and better efficiencies at Kids Headquarters can be traced to what Downs calls "one of the most misunderstood technologies"

whereas EPM is a business process that leverages BI. These technologies, combined with business process management (BPM), the third leg of EPM, are helping companies like Kids Headquarters optimize performance and turbo-charge profitability.

Higher level BPM, BI and EPM bring up many challenges. Should companies start these initiatives at the enterprise, division or department level? What are the relevant and effective

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ship-to location incorrect? Was the shipment mistakenly brought to the front door rather than the loading dock?

"Because Dell has a process mentality, they coordinate all the activities among the customer, the warehousing, the logistic provider and themselves," says

Jonathan Hornby, director of performance management, worldwide strategy group at SAS, points out that "just because you go with the best process, it doesn't mean that that process is in strategic benefit of the company." At this point, business

ting your data in order," says Eckerson of The Data Warehousing Institute. "Unless you do that, you are measuring vapor."

EPM is, fundamentally, the culmination of a successful BI strategy—when intelligence is strategically deployed across the organization.

"BI has become a mission-critical capability for organizations to derive maximum value in the context of their customer-facing initiatives and beyond," says Mike Lawrie, chief executive officer of Siebel Systems.

A Siebel customer agreed. "A real benefit is that it reflects data in real time and requires almost no resources to view the information," says Darryl Carroll, senior director of process integration at Honeywell Aerospace. "Previously, management generally still had access to information they needed, but there was an army of folks burning the midnight oil collecting this information, analyzing trends and putting it into a form that was presentable to management. By the time we were able to present the data, the data was stale."

Delivering the right information to the right people at the right time requires a turbo-charged, enterprise-wide analytical platform.

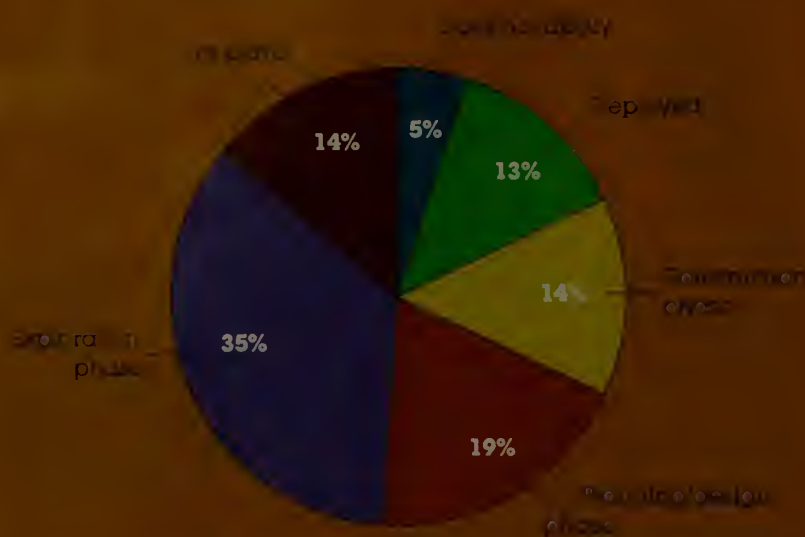
"When the data is used for enterprise performance management, a lot more eyes are on

it," says Patrick Morrissey, worldwide marketing director for enterprise performance management at Business Objects. "A lot more people have a lot more to lose if the data is not correct." This requires a company to be more strategic about its data in everything from data integration to real-time feeds from the data warehouse.

Ultimately, BI for EPM raises that to a

continued on page 11

Where Are Companies With BPM?



Eric Austvold, a research director for AMR Research. "Once the product is on the FedEx truck, they don't want it back because it erodes margins."

But BPM is clearly anything but simple. People often assume that improving a process inherently improves profitability, but that may not be the case. A typical process management routine is to reduce costs at all ends, but that might eliminate a loss leader that generates other business. The first step is to identify the key things that add value from the processes the company uses.

The biggest stumbling block to BPM is usually people issues. "People become leery when a machine makes decisions on their behalf," Austvold says. "They wonder at what point it is OK to let a machine think through all the options that a human used to."

process management can take all the information from the process to determine what value is delivered to the organization. That aligns strategy, cost, behavior and customer patterns.

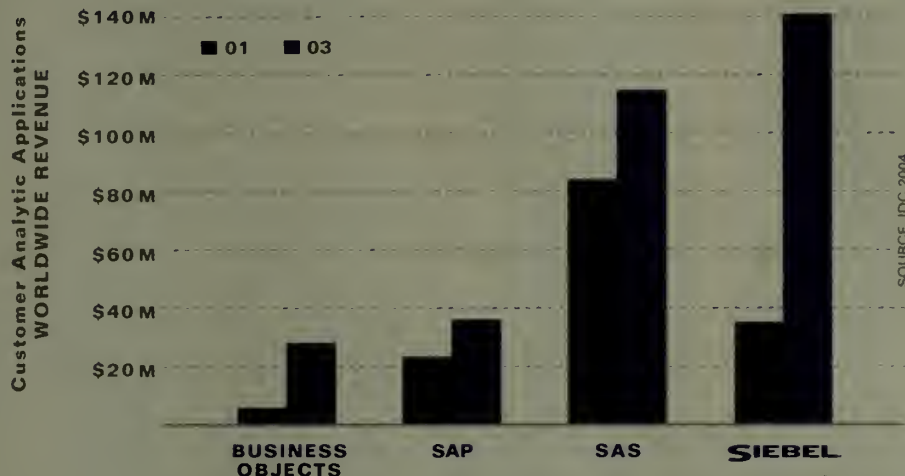
Business Intelligence

Even with the right processes, workers throughout an enterprise cannot make smart decisions unless they have the right data. When Kids Headquarters' Downs implemented his EPM strategy with Cognos software, one of his first steps was spending five months cleaning his data.

"One of the hardest parts of this is get-



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Are You Correctly Measuring The Wrong Thing?

In a survey by The Data Warehousing Institute, executives identified the key challenge to implementing enterprise performance management as delivering trustworthy data. The second biggest challenge was selecting key performance indicators (KPIs). In other words, while executives knew they had to measure something to improve performance, they weren't always sure what that something was.

KPIs are business drivers that predict future success. They are leading, not

lagging. Determining the right KPIs and finding out who owns them can be a Herculean task.

Most engineering firms, for instance, understand how to benchmark their general administrative costs against competitors. "The problem is knowing how to tie something like that into the organizational goals," says Rick Lowrey, executive vice president of Dellek Systems. If the goal, for example, is to increase the win rate for bids, the general administration costs somehow tie into that. Many companies

however, aren't always able to connect several different strategic goals with the KPIs of the business and have a clear view of it.

Finding the Right KPI

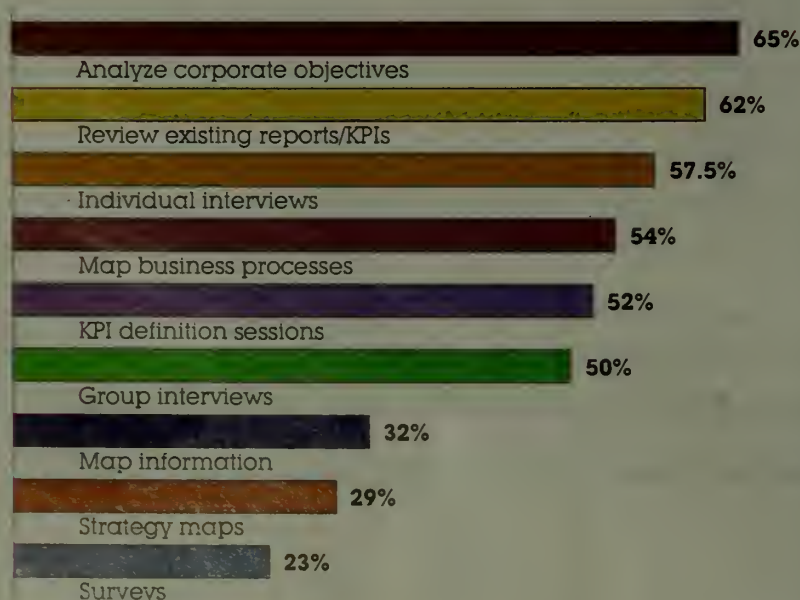
Wayne Eckerson, director of research at The Data Warehousing Institute, says a common problem occurs when companies approach KPIs from a purely departmental or a functional level without mapping the relationships to a high enough level. The result can be sub-optimization—when the metrics of one department inadvertently compromise the ability of another department to perform well.

Take this example: The primary goal might be to avoid stockouts of hot-selling items in retail outlets, but the warehousing and distribution units of the same company might be given incentives to keep inventory low to reduce costs. Both goals are reasonable. But if the KPIs are not coordinated between marketing and warehousing, it can hurt the more important goal.

Many companies have trouble sorting out the all performance indicators (APIs) from the KPIs because they lack a well-defined set of owners and processes that allow them to determine the business drivers and strategic measures from secondary influence measures, says Patrick Worthington, worldwide marketing director for enterprise performance management at Business Objects.

How Do You Pick What To Measure?

Most companies use a wide range of approaches to uncover the best KPIs for their business.



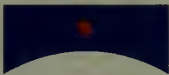
Source: A survey by The Data Warehousing Institute of 360 respondents



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A Method(ology) Without Madness

A systematic foundation is needed to manage business processes and performance.

Initiatives to manage business processes and enterprise performance can drive you mad unless there is a method behind them.

Enterprise performance management (EPM) and business process management (BPM) initiatives commonly use a systematic methodology across business and management processes. This methodology allows users to monitor, measure and improve performance in a structured environment that is the same for all business units.

"The most successful methodology is based on what you are already doing internally," says Patrick Morrissey, worldwide marketing director for enterprise performance management at Business Objects. "The driver for success is applying this methodology consistently."

Too often, though, companies cause problems by using too many different methodologies from department to department. At their heart, EPM and BPM initiatives demand coordination throughout the organization.

Consider Hewlett-Packard Services (HPS), which deployed a balanced scorecard methodology in early 2002 to measure customer service in its European region. The original system supported nine metrics and had 800 users. Within 18 months, the system grew to support 120 metrics and was used by 5,500 HPS employees throughout the world.

Standards Questions

The methodologies that are used to track and measure performance go under the umbrella term of "scorecarding." This shouldn't be confused with "a balanced scorecard," which is only a type of scorecarding. Among the others are economic value added, total quality management, activity-based costing and six sigma. The two most common methodologies for EPM and BPM initiatives are balanced

scorecards and six sigma.

Balanced scorecards, developed in 1992, attempt to translate an organization's mission statement and business drivers into a series of defined metrics. A fully implemented scorecard cascades down from the uppermost levels of the company ultimately providing a personal scorecard for each member of the organization.

"A balanced scorecard helps set the roadmap that lets companies identify the key goals they want to achieve and how to get there," says Jonathan Hornby, director of performance management, worldwide strategy group at SAS. Measuring employees through scorecards helps eliminate problems with compliance with EPM and BPM initiatives. "If you start measuring someone based on a scorecard, they will change their behavior to affect the scores," he notes. ■



Scoring Scorecards: Seven Secrets For Success

Take Your Time. Scorecard implementations usually take three to six months, and the longer they take the more effective they are.

Pilot Makes Perfect. Pilot programs significantly increase the chances of success.

Think Large. Large companies benefit more from scorecarding than smaller ones.

Go For C-level Sponsorship. Whether it's the CEO, CIO, COO or CFO, it's critical.

Get Dedicated. Many companies start with spreadsheets but dedicated scorecarding software becomes more necessary as data volume grows.

Don't Overdo Consultants. Leaving employees out of the process tends to isolate them, resulting in a less useful scorecard.

Go For The Customers. The greatest benefit from scorecarding is at the customer level, followed by the team, organization and divisional levels.

Source: SHAPS International Online Scorecard Study

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continued from page 5

new level, where everyone in the enterprise uses the data for strategic action to make not just strategic and tactical decisions but operational ones as well.

Enterprise Performance Management

Sound business processes and good data prepare a company for enterprise performance management. Getting a handle on EPM can be difficult because all sorts of people define EPM in subtly different ways and because it involves so many different elements. Technology, software, business intelligence, budgeting, financial reporting, scorecards,

lowest priced nuts and bolts. EPM can provide the deep visibility most companies now lack. It allows executives to see the interconnections of the actions of people throughout their organization.

Before a big management meeting with directors, some executives have teams spend weeks pulling together data and slides for their presentations. EPM provides a mechanism to gather the necessary data quickly, so teams can spend their time more productively—analyzing the information and acting on it. "How many times have managers gone into a meeting with information from different systems and spent all their time arguing over where

chipper/shredders and other products used Cognos technology to reduce its financial reporting process from three weeks to one week. What's more, the company now has more time to analyze data and get that information in front of employees more quickly.

Brigham and Women's Hospital relies on SAS technology so 650 employees can look at a 30-metric hospital scorecard and immediately see how their actions relate to overall strategy and change their goals accordingly.

Insurance companies are using EPM technology to reduce claims payout and administrative costs as well as to improve customer service and retention. "Speeding up the processing of property and casualty claims can have a major impact on customer satisfaction and, ultimately, customer retention," says Martyn Christian, chief marketing officer for FileNet. "Insurers are looking for more effective ways to handle large volumes of documentation to evaluate claims more quickly, easily and efficiently. At the same time, these companies are looking to reduce the cost of these processes and expose fraudulent activity."

The Common Misconception

The common misconception about EPM, says The Data Warehousing Institute's Eckerson, is that it is simply designed to improve performance in general. In truth, EPM is about focus: Helping firms narrow in on the few things that really drive business value instead of the many things that generate activity but don't contribute to a company's long-term health.

He views EPM as a four-stage process: strategize, plan, monitor, and act and adjust. The first two steps are strategic; the last two action-oriented. Together they form a closed loop between strategy and execution by adjusting strategy to fit the demands of the market.

Companies can get started with EPM

RESOURCES

AMR Research

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BPM Forum

<http://www.bpmforum.org>

Business Objects SA

<http://www.businessobjects.com>

Cognos Inc.

<http://www.cognos.com>

Deltek Systems Inc.

<http://www.deltek.com>

The Data Warehousing Institute

<http://www.dw-institute.com>

FileNet Corp.

<http://www.filenet.com>

SAS Institute Inc.

<http://www.sas.com>

Siebel Systems Inc.

<http://www.siebel.com>



dashboards, forecasting and key metrics have to be tied together in a seamless manner. Some people call EPM a combination of BI metrics and a methodology that provides information to users at the right time in the way they want to view it.

EPM is about improving communication. If a company's primary goal is quality, that might be undermined by an operations manager who buys the

data came from?" asks Karen Williams, vice president of product marketing, enterprise business intelligence at Cognos.

EPM provides many other day-to-day advantages too. It can optimize productivity, improve the quality of production, delivery time and customer satisfaction, and make all sorts of procedures more efficient. For example Murray Inc., an \$800-million maker of snowthrowers,

in three ways: "the big bang" enterprise-wide approach; the cross-functional approach; and the functional approach. Most vendors recommend the third. If you start at too high a level, often there is political infighting because people have different definitions of what success means and what the values of the organization are," SAS's Hornby says.

But in starting from the bottom up, departments must be on guard against creating new silos, so even functional EPM should begin with a high-level roadmap tied to corporate objectives.

"When talking about Process Performance Benchmarking, the first need is to establish measures with which an organization can evaluate its performance and ultimately determine success in supporting stated business objectives," says Chris Preston, director, EPM Products at FileNet. "Performance measures must be tied to the overall corporate/business objectives and need to be balanced in accordance with these goals. In other words, some goals may yield conflicting objectives on key performance indicator (KPI) performance."

Preston adds that "these KPIs need to be prioritized and weighted in accordance with these stated objectives and focused on striking the right balance, which can continuously shift as needs and market demands change. Even

after establishing benchmarks, you still absolutely need the operational visibility to give you insight into how you are actually performing within these processes and the performance of the operation overall. Again, the old adage holds true. You can't fix what you can't see. You can't improve on something until you actually understand what exactly it is that you are doing."

Closing The Gap

EPM requires companies to understand the data they have and deliver the key metrics in a form that users can understand, whether dashboards, scorecards embedded in corporate portals or ad hoc reports. At the same time, users must be able to drill down to detailed reports and interactive charts so they have the information they need to take action. Only in this way can employees align their daily actions with other departments and the strategic goals of the organization as a whole, closing the gap between strategy and execution.

There is no question that turbocharging an enterprise through BPM, BI and EPM can make profitability boom. Take, for instance, the problem of out-of-stocks. A BPM system allows companies to have a much clearer interpretation of demand signals. A regional sales manager could see, for example, that diapers or detergent is moving off the shelf more quickly at a certain location, which will quickly lead to stock-outs.

With a BPM system in place, the manager would be alerted quicker and might decide it makes good business sense to FedEx a special order to that location. AMR's Austvold notes that Procter & Gamble, which is fine-tuning its BPM system, estimates if it could reduce its stock-outs around the globe by 10 percent, it would have the same benefit to the company as creating another billion-dollar brand. ■

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SECOND ACT
Lazaridis and Balsillie gear up for explosive growth

The Squeeze On BlackBerry

As rivals close in, the wireless e-mail champ is looking to defend its head start

MIKE LAZARIDIS AND James L. Balsillie, the co-CEOs of Research In Motion Ltd. (RIM), have plenty of reason to feel on top of the world. After 20 years spent in the quiet university town of Waterloo, Ont., developing technology to deliver wireless e-mail, their BlackBerry gizmo is an outright phenom. What the iPod is to mobile music lovers, the BlackBerry

is to workers on the go. For the fiscal year ending in February, company sales should more than double, to \$1.35 billion, as net profits soar from \$52 million to around \$300 million and the number of global BlackBerry subscribers leaps from 1 million to 2.5 million. The stock price has quadrupled in the past year, to \$84. Amid all the hoopla, the chief executives calmly explain that they never doubted that they were on the right track. "We beavered away for years," says Balsillie.

"We never knew when the market was going to pop, but we never worried much that it would eventually happen."

Now companies across the tech industry are marshaling their forces to squash the BlackBerry. The rivals include Nokia, Dell, Hewlett-Packard, palmOne, Good Technology, Seven Networks, a passel of Asian device makers, and, yes, Microsoft. They're all jostling for a foothold in one of the few tech markets positioned for powerful growth. In the U.S. alone, researcher Yankee Group estimates, the market for corporate wireless e-mail totals 35 million workers. This means that a mouthwatering 90% of the market remains untapped. "This category is just getting started, and people don't want RIM to own it," says Danny Shader, CEO of Good Technology Inc., a startup that offers e-mail services on a broad range of devices and operating systems at a lower price than RIM.

Mounting competition is leading the two Canadians to shift their strategy. Rather than focus on defending the supremacy of the BlackBerry as an e-mail machine, they're adjusting to a world in which the vast majority of handhelds for e-mail and more will be made by their



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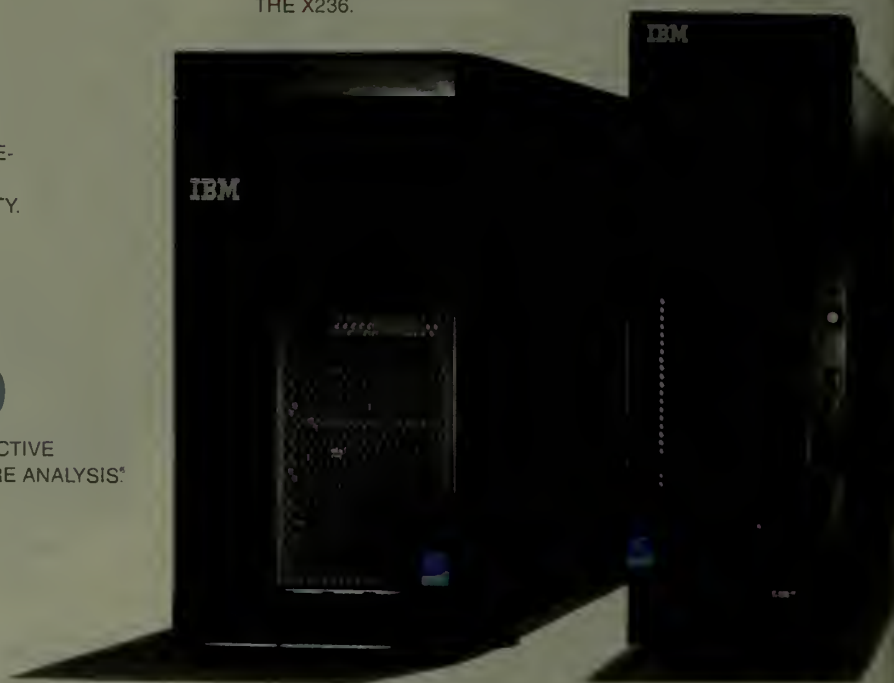
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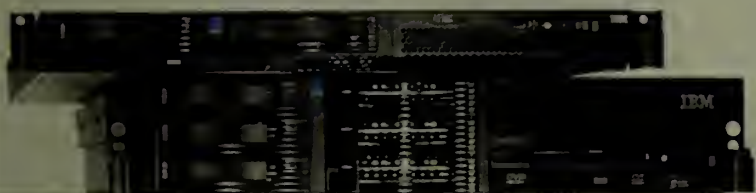
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competitors. RIM's gambit is to stake out leadership in software and services while protecting its hardware niche. The goal is to turn the BlackBerry service into the leading standard for corporate workers on the move.

With this shift, RIM's founders are attempting to sidestep the trap that snared Apple Computer Inc. a generation ago. Like RIM, Apple helped usher in a new industry by creating a superior soup-to-nuts product with the Macintosh computer. Yet as Apple discovered, fast-moving computing industries eventually divide into hardware and software markets. Innovation races ahead on both fronts, usually far too fast for a single company to control it all. Apple didn't license its software to other players—and ended up a niche player. RIM is pulling away from the Apple model and focusing more on software and services to stay on top. "It's encouraging that RIM is moving aggressively while it's early," says Scott Anthony, a partner at Innosight LLC, a Watertown, Mass.) consulting firm.

CLASH TASK

THE GROUNDWORK for RIM's strategy is coming into place. The company has established ties with more than 70 phone carriers around the world that offer BlackBerry subscriptions to corporate customers and pay BlackBerry between \$5 and \$10 per subscriber to direct the flow of data between devices and networks. At the same time, RIM has licensed its BlackBerry messaging software to a host of competitors, including PalmSource, Nokia, and Motorola. The company has also worked to widen its scope beyond e-mail, hammering out agreements for mobile data services and news

from the likes of Bloomberg Financial Markets, SAP, and PeopleSoft. For instance, an SAP program allows salespeople to tap into corporate networks on their BlackBerrys for account and order information. The goal is to keep broadening these mobile offerings—a key for expanding RIM's market for server software and subscriptions. "It's the right strategy," says David Nagel, president and CEO of PalmSource Inc., which is developing software that allows RIM to sit on top of the PalmSource operating system.

The first results of RIM's transition will start to be seen over the next few months. Around a dozen handsets using RIM's licensed technology are scheduled to roll out. They include a pricey full-keyboard phone from Nokia, the i500 Palm-powered smartphone from Samsung, and Motorola's MPX Pocket PC with a novel sideways keyboard.

Still, navigating this shift is one tricky job for Balsillie and Lazaridis. They must balance their need to cooperate with key customers of RIM's software and services against their desire to compete with the same companies in e-mail devices. At the same time, there's the risk that as e-mail becomes a standard feature on all sorts of phones, the divisions between RIM and the rest of the mobile-phone world will fade away. Ron Garriques, chief executive of Motorola's cell-phone division, says that phones with keyboards, while a small slice of the market today, are "becoming more interesting over time."

Perhaps the greater challenge is in software. RIM's developers in Waterloo

must come up with the world's best systems to handle global corporate communications on every type of mobile machine. "Right now, people love BlackBerry because of the experience," says Yankee Group analyst Eugene Signorini "Can [RIM] replicate that on other devices?"

Adding to the uncertainty, RIM is embroiled in a bitter patent dispute with NTP, a small, privately held firm in Arlington, Va., that holds a number of patents. NTP first filed a complaint in the U.S. District Court for the Eastern District of Virginia in November, 2001. Last year the court ruled in NTP's favor, a decision RIM appealed. A ruling is expected soon. Separately, the U.S. Patent Office is reviewing NTP's claims. Analysts say that if RIM loses, the court could force it to pay a licensing fee to NTP for eight years until the patents expire. The court

last year set a royalty of 8.55% of U.S. sales, which would cause 2006 earnings to drop by 18%, estimates Michael Wallace, an analyst at UBS.

As Balsillie sees it, the new strategy will turn RIM into a company led by high-margin software and services within the next few years. But with every passing month, that shift is looking like a longer haul. Why? Even as RIM pushes toward services, it's racking up stupendous growth in hardware. In September the company unveiled a new \$200 smartphone, the 7100. A departure from the traditional Pop Tart-size BlackBerry, the 7100 looks more like a traditional telephone and competes directly with palmOne Inc.'s Treo. Sales of all of RIM's handsets, affectionately known as "crackberries" for their addictiveness, are expected almost to triple in this fiscal year. This would drive hardware revenue to 76% of the total in the 2006 fiscal year, up from 58% last year.

Even in an industry where collaboration between competitors is grudgingly accepted, RIM's aggressive pursuit of two distinct businesses may spark dust-ups with competitors. And staying ahead in both hardware and software remains a major challenge. For RIM, it's a risky strategy of brinkmanship. But these Canadians are just as convinced as ever that they're on the right track. ■

—By Heather Green in Waterloo, Ont.,
with Cliff Edwards in San Mateo, Calif.,
and Roger O. Crockett in Chicago

Sowing BlackBerrys

Research in Motion has a huge lead in wireless e-mail with its popular BlackBerry devices. Now, as competition heats up, it's trying to make its technology the market standard. Here's RIM's strategy:

- LICENSE SOFTWARE** Key to gaining a wider audience is licensing the BlackBerry software to cell-phone and handheld computer makers. Nokia, Samsung, and Motorola are beginning to roll out devices that run its software.
- WORK WITH CARRIERS** RIM, which doesn't have its own direct sales team, depends on wireless companies to sell its devices and those that use its software. It has signed up 70 carriers to push its products and plans to sign up 70 others in the next year.
- OFFER SOFTWARE AND SERVICES** RIM is adjusting its software to make it easier for companies, ranging from SAP to Bloomberg, to offer their own services or software applications on a BlackBerry device.

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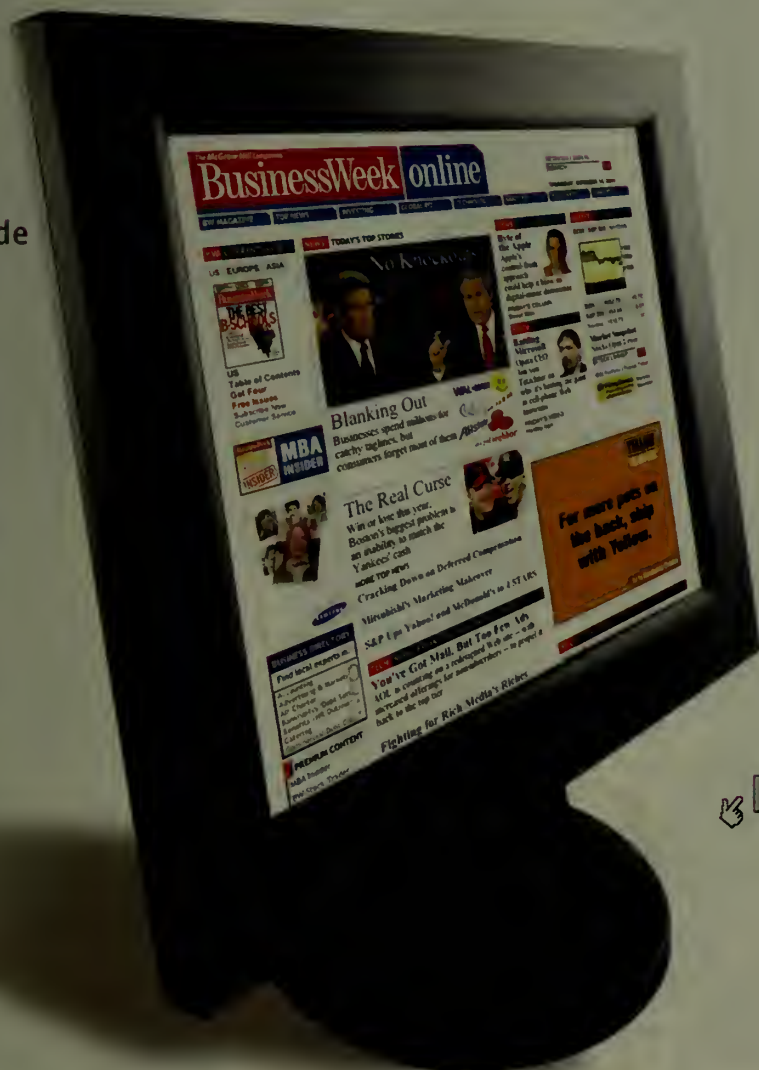
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HE OFFICE PARK IN northern New Jersey hardly looks like a place that plays a role in cutting-edge design. Hard by a highway interchange, the two-story building is about as distinctive as white rice. But climb the stairs to the second floor, and you'll see designers from Samsung Electronics Co. studying in pain-

staking detail the American consumer psyche. There, engineer Lee Byung Moo watches from behind a two-way mirror as three women and two men stuff a stainless steel refrigerator with the contents of a half-dozen bags of groceries. After the five have finished and given their opinions on several potential configurations of drawers and compartments, Lee and two others rush into the room to take photographs and note exactly where the "shoppers" have put the ice cream, chicken, beer, milk, and other food. "We want to know the tastes of American customers because we need to develop products that fit their lifestyle," says Lee.

Half a world away, Choi Won Min sits in a windowless room on the ground floor of a Seoul skyscraper—an equally unlikely spot to find the leading edge of design. He spends his days (and often his nights) in front of two piano keyboards, a phalanx of mixing consoles, and dozens of synthesizers. With his headphones on, he hits a note, listens intently, then tweaks a few settings and hits another key. His primary mission in the two-year-old lab: coming up with a suite of bells, boings, beeps, and buzzes for digital gadgets that will immediately say "Samsung" to users worldwide. In the past, "simple sounds seemed to be sufficient, but now we realize how important

(RIGHT) PHOTOGRAPH BY KI HO PARK/KISTONE

DESIGNING BUNCH
Team members in Seoul have got management's ear



sounds are in user interfaces,” Choi says.

Lee and Choi are foot soldiers in Samsung's continuing assault on the world of cool. In recent years, the South Korean company has begun gearing all it does, from financing to decision-making to training and labs, to make Samsung a finely tuned receptor of all the things that make its products must-haves in an increasingly competitive marketplace. Hundreds of millions of dollars have been spent spiffing up the look, feel, and function of everything from refrigerators and washing machines to cell phones and MP3 players. And the focus has been on research of the sort Lee and Choi are doing: finding out what's likely to sell before consumers even know they want it. The effort has paid off. Samsung has grown from a me-too producer of electronics and appliances into one of the world's leading brands—in large part because of its focus on design. “We want to be the Mercedes of home electronics,” says Yun Jong Yong, Samsung's chief executive.

The way Samsung's moving, you'd think it wants to be the Ferrari. This year, Samsung won five citation in the Industrial Design Excellence Awards (IDEA)—making it the first Asian company to win more prizes than any European or American rival. (The competition is sponsored by *BusinessWeek*, which publishes the results, but the laureates are selected by the Industrial Designers Society.) And since 2000, Samsung has earned a total of 100 citations at top design contests in the U.S., Europe, and Asia. Brokerage Hyundai Securities expects Samsung to earn \$10.3 billion on sales of \$52.8 billion this year, up

A GROWING COMMITMENT



from profits of \$5.2 billion and \$39.8 billion in revenues last year. (Although much of the increase comes from the semiconductor division, the company's snazzy consumer products also helped.) “Samsung is the poster child for using design to increase brand value and market share,” says Patrick Whitney, director of the Institute of Design at the Illinois Institute of Technology.

The change started in 1993, when Chairman Lee Kun Hee visited retailers in Los Angeles and saw that Samsung products were lost in the crowd, while those from Sony Corp. and a few others stood out. So he ordered his managers to concentrate less on cost saving and more on coming up with unique products. The bottom line: Great design could catapult Samsung to the top ranks of global brands.

DECADE OF DETERMINATION

THE BOSS SPOKE. Samsung listened. And the company's design push was under way. To attract better, younger designers, Samsung in 1994 moved its design center to Seoul from sleepy Suwon, a small city an hour south of the capital. That same year Samsung hired U.S. design firm IDEO to help develop a computer monitor—the first of many such collaborations with IDEO and other leading consultancies. Then in 1995, the company set up the Innovative Design Lab of Samsung, an in-house school where promising designers could study under experts from the Art Center College of Design in Pasadena, Calif., one of the top

LISTENING UP
Consumer preferences are a higher priority

Redesigning Samsung

Here's how Samsung is continuing to reinvent itself to keep its product designs at the leading edge

PIPELINE TO THE TOP

Designers can now go straight to top managers with ideas for new products. An award-winning rear-projection TV was developed by a designer who pitched it to the TV unit chief.

DESIGN-LED INNOVATION

Designers no longer have to build boxes around engineers' devices. Instead, engineers now often find a way to stuff the right parts inside the designers' boxes.

QUESTION AUTHORITY

Samsung is shedding traditional Confucian hierarchy, encouraging younger designers to challenge their superiors when they think something needs to be changed.

BACK TO SCHOOL

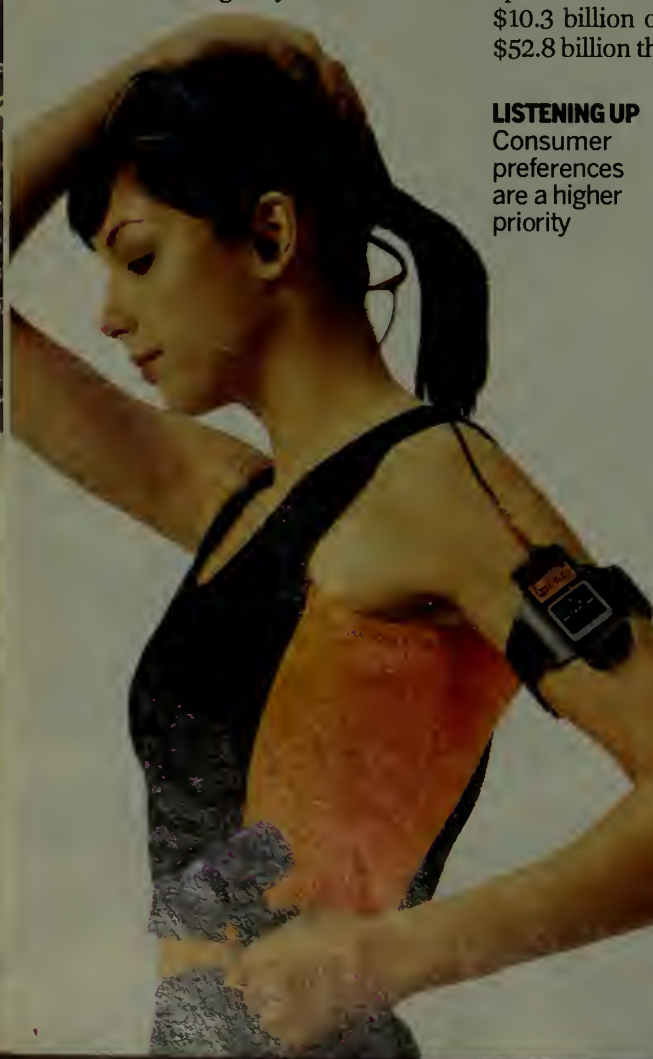
Designers are sent to work at furniture, fashion, and industrial design houses to keep on top of the latest trends.

GLOBAL REACH

Since 2000, Samsung has opened or expanded design centers in San Francisco, London, Tokyo, Los Angeles, and this year in Shanghai.

BEYOND HARDWARE

Samsung studies everything about how consumers actually use products—from how manuals to packaging to the beeps, buzzes, and bells that digital devices make.





Jeff came with:

The impression that all
financial advice was the same.

SAMSUNG IS FORGOING COST CUTS TO DRIVE UP THE VALUE OF ITS BRAND

U.S. design schools. Samsung designers were dispatched to Egypt and India, Paris and Frankfurt, New York and Washington to tour museums, visit icons of modern architecture, and explore ruins.

Just as important, Samsung's designers have broken through the barriers of Korea's traditional Confucian hierarchies. Although Korea has loosened up as democracy has taken hold in the last 15 years, respect for elders and a reluctance to speak out of turn are still the norm, and Samsung as a whole still holds lots of meetings where Confucian order prevails. But the design center is different. Located several minutes' walk from company headquarters, it's a place with no dress code, where some younger staffers dye their hair green or



STYLE SPIN

A washing machine that can please the eye

pink, and when everyone is encouraged to speak up and challenge their superiors. Designers work in three-

five-person teams, with members from various specialty areas and levels of seniority—all working as equals.

The wrenching departure from tradition has paid off. Virtually all of the 19 IDEA awards Samsung has won since 2000 are the fruit of such teams. Helped by its innovative designs and egalitarian approach, Samsung has emerged as the best-selling brand in high-end TVs in the U.S. and the world's largest LCD computer monitor producer, with 17% of the global market. And Samsung has sold more than 10 million SGH-E700s—the first clamshell phone with a hidden antenna—racking up

some \$1.2 billion in profits since its debut 14 months ago. “Good design is the most important way to differentiate ourselves from our competitors,” says CEO Yun.

Many of the new design ideas are coming from outside. Last year, Samsung started sending designers abroad to spend a few months at fashion houses, cosmetics specialists, or design consultancies to stay current with what's happening in other industries. Lee Yun Jung, a senior designer who works on color

and finishes, spent last autumn in residence at a furniture designer in Italy. While she gathered plenty of ideas for product surfaces, the real eye-opener was the relaxed culture of the place. “A 23-year-old novice could interrupt the 60-year-old master,” she marvels. Since returning, Lee has tried to be more open to ideas percolating up from the bottom of her department.

Today, Samsung knows it can't afford to let up. It's the first Asian company outside of Japan to use design to vault to the first tier of global companies. But in the Digital Age it's not too hard for strivers such as Lenovo of China and BenQ to make products that approach the quality of long-standing industry giant



UNDER OBSERVATION
Testing products in Samsung's usability lab



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such as Sony, Panasonic, or Philips Electronics. Samsung, of course, was an upstart itself not long ago. It was the transition from analog to digital that gave the Korean company the opening it needed. "In the analog age, Samsung devoted most of its energy trying to catch up with Japanese leaders, but the arrival of digital put everybody on the same starting line," says Chin Dae Je, Korea's Information & Communication Minister and president of Samsung Electronics before joining the Cabinet last year.

These rivals—whether newcomer or veteran—aren't standing still. The newbies often hire U.S., Japanese, or Italian design consultancies to help them shape products that won't get lost in the crush of goods at Best Buy or Circuit City Stores. And those Asian upstarts are all looking to Samsung as a role model for their own transformation into global brands. The likes of Sony and Matsushita, meanwhile, are also placing a renewed emphasis on creating stand-out products. "Sony has been losing some of its edge in design," says Makoto Kogure, head of the Japanese giant's TV division. "Now we're drastically changing and [creating a] Sony identity."

FRONT-LOADED DESIGN

SO SAMSUNG MUST CONTINUE to reinvent itself. In the past four years, the company has doubled its design staff, to 470, adding 120 of those just in the past 12 months. And since 2000, its design budget has been increasing 20% to 30% annually. To



**SELF-
PORTRAIT**
Flip-screen
digital
camera
phone

keep an eye on trends in its most important markets, Samsung now has design centers in London, Los Angeles, San Francisco, and Tokyo, and this year it opened one in Shanghai. More important, Samsung is changing the processes and procedures in its design department and giving designers more power and influence not just how products look but also what gets built. "Just as a lizard cuts off its own tail to move on, we will have to break with the past to move forward," says Chun Kook Hyun, the senior vice-president who runs design operations.

Samsung's designers these days no longer have to find a way to put their boxes around the device

that engineers cook up. Instead, they often give concepts to engineers, who must then build the machine inside the box dreamed up by the designers. James Choe, for instance, recently studied research showing that consumers prefer printers in which the paper lies flat rather than feeding in vertically. Engineers working on the same project, however, preferred a vertical model because it would cut the production cost of a \$110 printer by about 10%. Before Choe started at Samsung three years ago, the engineers might have won. But when the desktop laser printer rolled out last year, Choe's design had prevailed. "The engineers didn't like it, but in the end management listened to us," he says.

Sometimes the designers come up with en-

From Laggard To Leader

How Samsung
ratcheted up its
design emphasis



1969

Samsung Electronics established as maker of TVs with technology borrowed from Sanyo.

1977

Samsung introduces its first color TV.

1980s

Focuses on undercutting Japanese rivals with me-too products. Design is an afterthought.

1988

Launches first mobile phone.

1993

Chairman Lee Kun Hee tells execs to reinvent Samsung through design.

1994

Hires U.S. design consultancy IDEO to help develop computer monitors.



1995

Sets up in-house design school, the Innovative Design Lab of Samsung.

1996

Lee declares "Year of Design Revolution," stressing that designers should lead in product planning.

1998

Asian financial crisis dents Samsung's ambitions; design staff cut by 28%.

2000

Samsung once again focuses on design, and CEO Yun Jong Yong calls for design-led management.

2001

Yun institutes quarterly design meetings for top execs; opens design labs in Los Angeles and London.

2002

Samsung's "usability laboratory" inaugurated in downtown Seoul.

2004

Samsung wins a total of 33 awards at top design contests in the U.S., Europe, and Asia.

DESIGN CHIEF
Choi Gee Sung





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tirely new product categories. Kang Yun Je thought Samsung could do better than its rivals with a sleek, silver, rear-projection TV sporting a curved back and superthin edges, so that when viewed from an angle it looks as thin as an LCD TV. "When we first came up with the design, we had no guarantee it could be made," says Kang, a shaggy 36-year-old who sports a goatee and wears his shirt untucked. "So I went to the head of engineering, and he said that if I could give him some time and resources, he'd try to do it."

Where to get the resources? To make sure designers get heard, Samsung has created the post of chief design officer—something few other companies have bothered to do. And to make sure top execs stay attuned to the importance of the issue, CEO Yun holds quarterly design meetings where the chiefs of all the business units review new products and evaluate their designs. So Kang was able to simply call Choi Gee

AFTER SAMSUNG'S RECENT SUCCESS, ITS RIVALS ARE IN HOT PURSUIT

Sung, head of Samsung's TV, computer, and audio businesses and chief design officer since January, to secure backing for the TV project. A few years ago, Kang says, a designer at his level would have had to go through the marketing department and midlevel execs before reaching top management. Choi liked what he saw and gave Kang the go-ahead on the TV. Smart move: The TV, code-named L7, won a silver prize in the IDEA competition

SIDE-BY-SIDE
It's cool on the outside, too



this year and is expected to be a big seller. Samsung's design focus goes well beyond just the look and feel of its products. The company is working to improve the way people use

and control gadgets, and two years ago it opened what it calls a "usability laboratory" in downtown Seoul. There, across the hall from where Choi Won Min taps away at his synthesizers in search of the perfect sound, engineers and consumers alike test everything from getting products out of the box to the icons and menus on screens. "In the past, physical design was the focal point," says Chief Design Officer Choi (no

SCREEN GEMS
The L7 won a silver IDEA prize

they do in a Korean home. On a recent Friday, one engineer padded around in his slippers making rice in a Samsung steamer, another checked out a washing machine, and a third played with the controls on a computer monitor. Behind a two-way mirror, an engineer controlled four high-definition cameras that could zoom in on any corner of the room to record the sessions and save them for later study.

It's that commitment to research that has given Samsung its edge. Many designers sit in focus groups and watch closely as potential customers provide feedback on their new models. And each foreign lab has a usability searcher on site—unusual in the industry. Hwang Chang Hwa, Samsung's principal mobile-phone designer, faced complaints about the SPH-S2300, a three-megapixel camera phone. Technophiles and camera aficionados liked the optical zoom lens—a first in a camera phone—but other consumers didn't like the thickness of the lens. Most of all, young users hated the clumsy keypad, which was laid out in two rows of six keys along the bottom of the screen in order to keep the phone short enough to fit in a pocket. So when it came time to upgrade the phone, Samsung's designers listened. The new, five-megapixel successor sports a smaller lens that allows for a slimmer body, and it slides open, exposing a larger screen but leaving room for the traditional layout of three keys by four.

Can Samsung stay on top of its design game? Some skeptics say the company still doesn't have the breadth and depth in design of Sony, or the ingrained design culture of Apple Computer Corp. "Samsung has improved, but I don't see an identity in their design that really speaks to consumers," says Jim Wick, Motorola Inc.'s vice-president in charge of designing cell phones. Still, few would deny that Samsung has managed to inject the importance of design into its corporate DNA. In this era of cutthroat competition, that may be just what it takes to create a lasting advantage. ■

BusinessWeek online For a Q&A with Samsung design boss Chur Kook Hyun and a slide show of Samsung's newest designs, go to www.businessweek.com/magazine/extra.htm

relation to the sound of the designer). "In the future, the user interface will be emphasized more."

The usability lab was built to provide a lifeline for product designers. It looks like a typical living room, with a kitchen in the corner for testing cooking appliances. Entering the room, designers and engineers kick off their shoes just



FLUFFY EVERY TIME
Samsung's vision of the perfect rice cooker

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A Chemist Heats Up Dow Corning

CEO Burns is driving income gains and a new focus on high-growth markets

IN 1967, WHEN CHEMIST SHAILER L. Bass retired as chief executive of Dow Corning Corp., Stephanie A. Burns was a seventh-grader in Ann Arbor, Mich., who spent her days dreaming about becoming a scientist. After school, Burns dissected frogs and snakes and did chemistry experiments with her older brother. She stuck with it, getting a doctorate in organic chemistry in 1982 and then a research job at Dow Corning, the privately held joint venture between Dow Chemical

Co. and Corning Inc. She made her way from the lab to the ranks of management, and in January, 2004, was named CEO. For the first time since Bass, a chemist is heading Dow Corning once again.

The company needs Burns's scientific brainpower. Dow Corning is the world's biggest maker of silicones, a family of silicone-based compounds used in sealants, adhesives, cosmetics, and, most famously, breast implants. In June, the Midland (Mich.)-based company emerged from nine years of Chapter 11 bankruptcy pro-

BURNS Her goal: At least 20% of revenue from new products

tection—its refuge from thousands of lawsuits filed by women who believe leaky implants made them sick. Dow Corning will spend the next 15 years financing \$3.3 billion in settlement payments. Meanwhile, the industrial markets the company serves are nearly saturated. To rev up profits, Burns needs to pioneer new markets.

COOL UNDER FIRE

BURNS, 49, IS DRAWING ON her own experience in the lab to guide her company's rebirth. As a young scientist her specialties were inventing silicone compounds that could withstand high temperatures, as well as developing semiconductor materials for autos. Now she's nudging scientists to invent new compounds for other high-growth markets such as electronics, pharmaceuticals, and aerospace. Dow Corning's chairman, Gary A. Anderson—who handpicked Burns to replace him as CEO—says her ability to assess ideas right down to their chemical formulas “gives her a definite advantage in judging where we should devote our research efforts. Burns is also speeding up Dow Corning's expansion in China, India, and other markets where silicone use is a fraction of what it is in the U.S.

The company is making progress. In the nine months that ended on Sept. 30, Burns's China initiatives helped drive net income up 23% over the same period in 2003, to \$167.8 million, while revenue jumped 19%, to \$2.5 billion. Still, Burns concedes that she's nowhere near achieving her ultimate goal: to derive at least 20% of annual sales from products that are less than five years old. “Innovation is a key priority for this company,” she says.

Not that long ago, virtually no one had much faith in Dow Corning's future. Formed in 1943, the company hit on the idea of making breast implants with silicone in the 1960s. Originally designed for women who had mastectomies, the implant became a sensation as a cosmetic device. But some women developed autoimmune diseases such as lupus, which the company attributed to the implants. Although the allegations were never scientifically proven, Dow Corning pulled the product in 1992. A wave of injury lawsuits followed, forcing the company into bankruptcy.

The firestorm over implants put Burns on the path to the CEO suite. She had not helped develop the product, but in 1994, at the siege on the company intensified, Burns was named director of women's health. Personable and gregarious, she was



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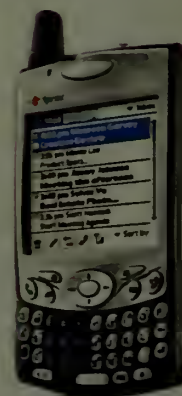
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People Scientists

even the tough job of acting as liaison between the Food & Drug Administration, plaintiffs, and Dow Corning, relaying results from independent research on the alleged side effects of implants. She even appeared on *The Oprah Winfrey Show*, bravely rebutting printed accusations.

Anderson, who was then CEO, was so impressed with Burns's ability to explain complex data while staying cool under fire that he began promoting her, first to director of science and technology in Europe, and then to executive vice-president. "She calmed the waters," Anderson recalls. "That was the key to her ascent."

EVVED-UP RESEARCH

BURNS, A MOTHER AND grandmother who is married to a Dow Corning chemist, spends much of her off-hours trying to get children excited about science—especially girls. She preaches to industry groups about the importance of science education in schools, and she set up a mentoring program that sends Dow Corning scientists to local classrooms. As one of the few women at the top of the chemical industry, Burns sees herself as a role model. "Science is no longer cool," she says. "That's really tragic."

Burns was always an enthusiastic science student, enjoying both the discovery process and the camaraderie of most labs. As a graduate student at Iowa State University, she often set off dry-ice bombs to

startle her classmates. "She was a heck of a lot of fun," says her former adviser, Thomas J. Barton, now director of the Energy Dept.'s laboratory in Ames, Iowa.

While some might shy away from the corporate-turnaround test she faces today, Burns savors the challenge. Even before she moved into the top job, Burns was steering the company into new territory. In 2003 she helped shepherd Dow Corning's \$115 million acquisition of Sterling Semiconductor Inc., which makes silicon carbide microchips that are used to power devices in the aerospace and automotive markets. Dow Corning is also making more efficient silicon wafers for solar panels—a business that is growing 30% a year. In the lab, meanwhile, researchers are mixing silicon with carbon-based compounds to try to develop newfangled fabrics, building materials, and pharmaceutical products such as skin patches that emit drugs.

Burns's ex-lab partners understand the immensity of the challenge at hand. "She is giving us the responsibility to change the face of the corporation," says Thomas H. Lane, a veteran Dow Corning scientist. It's no small task. But with a chemist at the helm, Dow Corning's innovation makeover is well under way. ■

—By Michael Arndt in Midland, Mich.

HIGH-PURITY SILICON WAFER



BIO

Stephanie A. Burns

Many off-hours go to helping get children, especially girls, excited about science

BORN Jan. 24, 1955, Torrington, Wyo.

EDUCATION BS, chemistry, Florida International University, 1977; PhD, organic chemistry, Iowa State University, 1982.

CURRENT JOB President and CEO, Dow Corning Corp.

CAREER PATH Started at Dow Corning in 1983 as a researcher. Promoted to director of women's health in 1994. Became director of science and

technology in Europe in 1997, then executive vice-president and director in 2000. Named president and chief operating officer in 2003. Promoted to CEO in January, 2004.

FAMILY Married to Gary, a Dow Corning chemist. One daughter, two grandchildren.

HOBBIES Golfing and scuba diving.

CURRENT READING *Harry Potter and the Order of the Phoenix*.

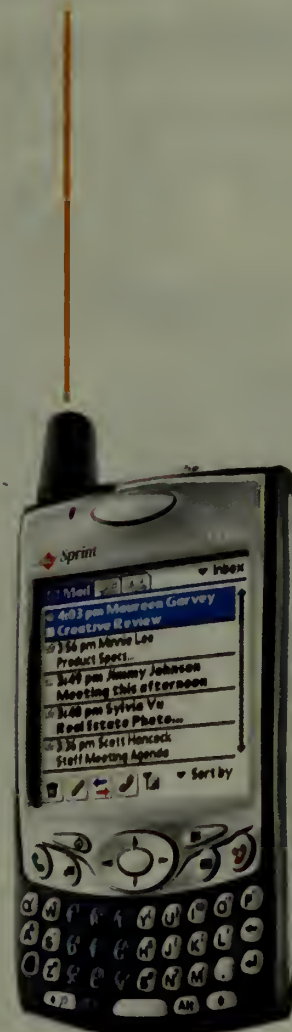
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THE CHINA



They are the three scariest words in U.S. industry. Cut your price at least 30% or lose your customer. Nearly every manufacturer is facing this challenge from furniture to networking gear. The result: A massive shift in economic power is under way. BY PETE KENNICOTT AND DEXTER ROBERTS

A PRICE



SOUTH OF SHANGHAI
Lacquer Craft's vast
plant seems more
suited to assembling
Boeing 747s

PHOTOGRAPH BY ANDREW ROWAT

FROM THE RICH WALNUT PANELING AND carved arches to the molded Italian Renaissance patterns on the ceiling, the circa 1925 council chamber room of Akron's municipal hall evokes a time when the America's manufacturing heartland was at the peak of its power. But when the U.S.-China Economic & Security Review Commission, a congressionally appointed panel, convened there on Sept. 23, it was not to discuss power but decline. One after another, economists, union officials, and small manufacturers took the microphone to describe the devastation Chinese competitors are inflicting on U.S. industries, from kitchenware and car tires to electronic circuit boards.

These aren't stories of mundane sunset industries equipped with antiquated technology. David W. Johnson, CEO of 92-year-old Summitville Tiles Inc. in Summitville, Ohio, described how imports forced him to shut a state-of-the-art, \$120 million tile-making plant four football fields long, sending Summitville into Chapter 11 bankruptcy protection. Now, a tenfold surge in high-quality Chinese imports at "below our manufacturing costs" threatens to polish Summitville off. Makers of precision machine tools and plastic molds—essential supports of America's industrial architecture—told how their business has shrunk as home-appliance makers have shifted manufacturing from Ohio to China. Despite buying the best computer-controlled gear, Douglas S. Bartlett reported that at his Cary (Ill.)-based Bartlett Manufacturing Co., a maker of high-end circuit boards for aerospace and automotive customers, sales are half the late-1990s level and the workforce is one-third smaller. He waved a board Bartlett makes for a U.S. Navy submarine-detection device. His buyer says he can get the same board overseas for 40% less. "From experience I can only assume this is the Chinese price," Bartlett said. "We have faced competition in the past. What is dramatically different about China is that they are about half the price."

Where the Jobs Went

"THE CHINA PRICE." THEY ARE the three scariest words in U.S. industry. In general, it means 30% to 50% less than what you can possibly make something for in the U.S. In the worst cases, it means below your cost of materials. Makers of apparel, footwear, electric appliances, and plastics products, which have been shutting U.S. factories for decades, know well the futility of trying to match the China price. It has been a big factor in the loss of 2.7 million manufacturing jobs since 2000. Meanwhile, America's deficit with China keeps



Low wages and high tech

soaring to new records. It is likely to pass \$150 billion this year.

Now, manufacturers and workers who never thought they had to worry about the China price are confronting the new math of the mainland. These companies had once held their own against imports mostly because their businesses required advanced skills, heavy investment, and proximity to customers. Many of these companies are in the small-to-midsize sector, which makes up 37% of U.S. manufacturing. The China price is even being felt in high tech. Chinese exports of advanced networking gear, still at a low level, are already affecting prices. And there's talk by some that China could eventually become a major car exporter.

Multinationals have accelerated the mainland's industrialization by shifting production there, and midsize companies that can are following suit. The alternative is to stay at home and fight—and probably lose. Ohio State University business professor Oded Shenkar, author of the new book *The Chinese Century*

THE CHINA CHALLENGE

Why should U.S. manufacturers worry when they have weathered decades of competition from Japan, Korea, and Europe? Because China is different. Here's why:

SPEED

Earlier rivals usually took years to build up an American presence. Chinese competition often arrives en masse and seizes share rapidly with unbeatable prices, leaving little time for U.S. companies to adjust.

BREADTH

Other Asian nations shed labor-intensive work as they industrialized, but China is gaining share in low-end work such as garments and simple assembly at the same time it's advancing into higher-value areas such as digital electronics.

COMPETITION

Japan and Korea are limited players in many industries. But in China, dozens of manufacturers battle for share in the domestic markets for appliances, cell phones, cars, and more, keeping everyone lean.

ALLIANCES

Unlike Japan or Korea, China welcomes foreign investment in key industries. Foreign ventures account for 60% of exports and a big share of local sales, so it's tough to complain that it is closed.

EXPORT CENTRAL China is adding customers and suppliers rapidly

Combine the two, and **America has a problem**"

ears many war stories from local companies. He gives it to them straight: "If you still make anything labor intensive, get out now other than bleed to death. Shaving 5% here and there won't work." Chinese producers can make the same adjustments. "You need an entirely new business model to compete."

America has survived import waves before, from Japan, South Korea, and Mexico. And it has lived with China for two decades. But something very different is happening. The assumption has long been that the U.S. and other industrialized nations will keep leading in knowledge-intensive industries while developing nations focus on lower-skill sectors. That's now open to debate. What is stunning about China is that for the first time we have a huge, poor country that can compete both with very low wages and in high tech," says Harvard University economist Richard B. Freeman. "Combine the two, and America has a problem."

How much of a problem? That's in fierce dispute. On one side,

the benefits of the relationship with China are enormous. After years of struggling to crack the mainland market, U.S. multinationals from General Motors to Procter & Gamble and Motorola are finally reaping rich profits. They're making cell phones, shampoo, autos, and PCs in China and selling them to its middle class of some 100 million people, a group that should more than double in size by 2010. "Our commercial success in China is important to our competitiveness worldwide," says Motorola China Chairman Gene Delaney.

By outsourcing components and hardware from China, U.S. companies have sharply boosted their return on capital. China's trade barriers continue to come down, part of its agreement to enter the World Trade Organization in 2001. Big new opportunities will emerge for U.S. insurers, banks, and retailers. China's surging demand for raw materials and commodities has driven prices up worldwide, creating a windfall for U.S. steelmakers, miners, and lumber companies. The cheap cost of Chinese goods has kept inflation low in the U.S. and fueled a consumer boom that helped America weather a recession and kept global growth on track.

But there's a huge cost to the China relationship, too. Foremost is the question of America's huge trade deficit, of which China is the largest and fastest-growing part. While U.S. consumers binge



THE CHINA PRICE

MACHINE MOLDS

PRICE GAP

UP TO **50%**

XCel Mold of Ohio, bid \$2.07 million to supply a set of plastic molds to a U.S. appliance maker. It lost the business when a Chinese supplier bid \$1.44 million

Data: XCel Mold

ACCESS

Retail giants such as Wal-Mart that import directly help Chinese electronics makers build U.S. market share without the need to spend as much on distribution and ads as Sony, Sharp, and Samsung did.

U.S. POLICY

When imbalances got out of hand in the '80s and '90s the U.S. threatened sanctions to prod Japan and China to address trade grievances. China's entry into the WTO limits U.S. ability to act unilaterally.

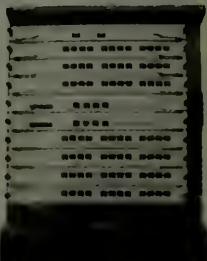
both an power itself ing the biggest for cars, ces, cell , and more. es China lled ies of scale.

on Chinese-made goods, the U.S. balance-of-payments deficit is nearing a record 6% of gross domestic product. The trade shortfall—coupled with the U.S. budget deficit—is driving the dollar ever downward, raising fears that cracks will appear in the global financial system. And by keeping its currency pegged to the greenback at a level analysts see as undervalued, China amplifies the problem.

America's Eroding Base

THE DEFICIT WITH CHINA will keep widening under most projections. That raises the issue: Will America's industrial base erode to a dangerous level? So far the hardest-hit industries have been those that were destined to migrate to low-cost nations anyway. But China is ramping up rapidly in more advanced industries where America remains competitive, adding state-of-the-art capacity in cars, specialty steel, petrochemicals, and microchips. These plants are aimed at meeting insatiable demand in China. But the danger is that if China's growth stalls, the resulting glut will turn into another export wave and disrupt whole new strata of American industry. "As producers in China end up with significant unused capacity, they will try to be much more creative in how they deploy it," says Jim Hemerling, a senior vice-president at Boston Consulting Group's Shanghai office.

That's why China is an even thornier trade issue for the U.S. than Japan was in the 1980s. It's clear some Chinese exporters cheat, from intellectual-property theft and dumping to securing unfair subsidies. Washington can get much more aggressive in fighting violations of trade law. But broader protectionism is a nonstarter. On a practical level the U.S. is now so dependent on Chinese suppliers that resurrecting trade barriers would just raise costs and diminish the real benefits that China trade confers. Also, unlike Japan 20 years ago, China is a much more open economy. It continues to lower tariffs and even runs a slight



THE CHINA PRICE

NETWORKING EQUIPMENT

PRICE GAP
25%

Datacom switch for corporations: Made in China for 3Com with a **\$183,000** list price. Cisco's comparable switch lists for **\$245,000**.

Data: 3Com

trade deficit with the whole world—which makes the U.S.'s deficit with China all the more glaring. Hiking the value of the yuan 30% might help. But that's unlikely. For one thing, Beijing fears what such a shift would do to jobs—and the value of its \$515 billion in foreign reserves. The real solution is for the U.S. to reduce its twin deficits on its own—but that's more America's issue than China's.

Meanwhile, U.S. companies are no longer investing in much new capacity at home, and the ranks of U.S. engineers are thinning. In contrast, China is emerging as the most competitive manufacturing platform ever. Chief among its formidable assets is its cheap labor, from \$120-a-month production workers to \$2,000-a-month chip designers. Even in sophisticated electronics industries, where direct labor is less than 10% of costs, China's low wages are reflected in the entire supply chain—components, office workers, cargo handling—you name it.

China is also propelled by an enormous domestic market that brings economies of scale, feverish local rivalry that keeps prices low, an army of engineers that is growing by 350,000 annually, young workers and managers willing to put in 12-hour days and work weekends, an unparalleled component and material base in electronics and light industry, and an entrepreneurial zeal to do whatever it takes to please big retailers such as Wal-Mart Stores, Target, Best Buy, and J.C. Penney. "The reason practically

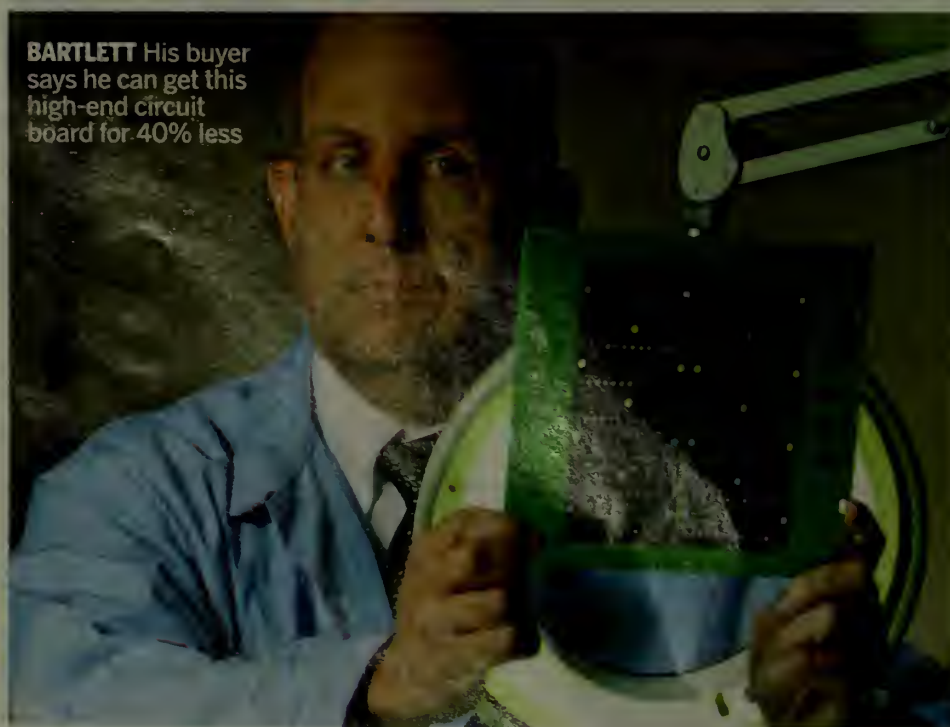
all home furnishings are now made in China factories is that they simply are better suppliers," says Janet E. Fox, vice-president for international procurement at J.C. Penny Co. "American manufacturers aren't even in the same game."

Fox's point is important. China's competitive advantages are built on much more than unfair trade practices. Some 70% of exports now come from private companies and foreign venture mainly owned by Taiwanese, Hong Kong, Japanese, and U.S. companies that have brought access to foreign markets, advanced technology, and managerial knowhow. Aside from cheap

land and tax breaks in some areas, private Chinese manufacturers get minimal government help. "The Chinese government cannot afford to offer financial support to the export economy," says business professor Gu Kejian of People's University in Beijing. And as capital floods in and modern plants are built in China, efficiencies improve dramatically. The productivity of private industry in China has grown an astounding 17% annually for five years according to the U.S. Conference Board.

China needs U.S. imports, though not as much as imagined when Beijing agreed to join the WTO. U.S. exports to China have risen 25% to 35% annually in the past two years. But China's exports still outstrip its imports from the U.S. by 5 to 1. The U.S. sells about \$2.4 billion worth of aircraft a year, and its semiconductor exports tripled in three years. Otherwise the U.S. looks like a developing nation. It runs surpluses in commodities such as oil seeds, grains, iron, wood pulp, and raw animal hides.

Meanwhile, the Chinese keep expanding



BARTLETT His buyer says he can get this high-end circuit board for 40% less

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FLEXTRONICS The contract manufacturer employs 41,000 people in China

their export base. Chinese competition arrives so fast that it's nearly impossible to adjust through the usual strategies, such as automating or squeezing suppliers. The Japanese, South Koreans, and Europeans often took "four or five years to develop their place in the market," says Robert B. Cassidy, a former U.S. Trade Representative official who helped negotiate China's entry into the WTO and now works for Washington law firm Collier Shannon Scott, which wages dumping cases on behalf of U.S. clients. "China overwhelms a market so quickly you don't see it coming."

"Shock and Awe"

GEORGETOWN STEEL CO. is a case in point. The Georgetown (S.C.) maker of wire rods used in everything from bridge cables to ball bearings had battled Asian and Mexican imports for years. But last year it shut its 600-worker plant, citing a tenfold leap in Chinese imports, to 252,000 tons, from 2001 to 2003. International Steel Group Inc. has since bought the facility after U.S. anti-dumping duties on imports and a rise in global demand helped hike domestic prices. The Gardiner (Mass.) plant of Seaman Paper Co., a maker of crepe and decorative paper, is highly automated. Yet Chinese imports have grabbed a third of the market. It sells 81-foot streamers to big retailers for as little as 9¢ each. That's below Seaman's cost of materials. "We thought we could offset Chinese labor cost by automating, but we just couldn't," says Seaman President George Jones III.

In bedroom furniture, 59 U.S. plants employing 15,500 workers have closed since January, 2001, as Chinese imports have rocketed 221%, to \$1.4 billion—half of the U.S. market. Prices have plunged 30%. Dumping certainly seems to be one factor: At its Galax (Va.) factory, Vaughan-Bassett Furni-

ture Co. displays a Chinese knockoff of one of its dressers that wholesales for \$105—below the world market cost for the wood. But the main competition comes from Chinese megaplants that sell directly to U.S. retailers and can get a new design into mass production in two months. The new Chinese factories of suppliers such as Lacquer Craft Furniture, Markor, and Shing Mark, some of them Taiwanese owned, employ thousands and are so big they seem meant to build Boeing 747s, making most U.S. factories look like cottage industries. "The first wave is shock and awe," says John D. Bassett III, CEO of Vaughan-Bassett, whose sales

and workforce have shrunk even though it has boosted productivity fivefold at its 600-worker Galax plant since 1995 by investing in computer-controlled wood drying, cutting, and carving gear. "American industry has never encountered [such] competition."

As component industries and design work follow assembly lines to China, key elements of the U.S. industrial base are beginning to erode. American plastic-molding and machine-tool industries have shrunk dramatically in the past five years. Tak Incoe Corp. in Troy, Mich., a maker of steel components for plastic-injection machines. "When the economy turned soft, we anticipated the business would come back," says Incoe CEO Robert Hoff. "But it didn't. We saw our customer base either close or migrate to China." The U.S. printed-circuit-board industry has seen sales go from \$11 billion to under \$5 billion since 2001. In that time, PCB exports from China have more than doubled to a projected \$3.4 billion this year, says market researcher Global Sources Ltd. Most U.S. production of key electronics materials, such as copper-clad laminates, has fled, too. "The whole industry is hollowing out," says Joseph C. Fehsenfeld, CEO of Midwest Printed Circuit Services Inc. in Round Lake Beach, Ill.

The migration of electronics to China began when the Taiwanese shifted plants and suppliers across the Taiwan Strait in the late 1990s. As recently as four years ago, though, the U.S. exported \$4 billion in computer hardware. Since the tech crash that number has slid to \$28 billion as the industry headed en masse for China, which is even more competitive than Taiwan. "All electronics hardware manufacturing is going to China," says Michael Marks, CEO of Flextronics Corp., a contract manufacturer that employs 41,000 in China. Flextronics and other companies are hiring Chinese engineers to design the products assembled there. "There is



THE CHINA PRICE

BEDROOM FURNITURE

PRICE GAP

40%

Mission-style bed made in China for Universal retails for \$829. U.S. models cost up to \$1,800.

Data: U.S. Census Bureau

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3Com is getting **four engineers** for the price of one

myth that the U.S. would remain the knowledge economy and China the sweatshop," says BCG's Hemerling. "Increasingly, this is no longer the case."

A visit to Flextronics' campus in the Pearl River Delta town of Doumen vividly illustrates Marks's point. The site employs 18,000 workers making cell phones, X-box game consoles, PCs, and other hardware in 13 factories sprawled over 149 acres. The bamboo scaffolding is about to come down on an additional 720,000-square-foot factory nearing completion. Almost every chemical, component, plastic, machine tool, and packing material Flextronics needs is available from thousands of suppliers within a two-hour drive of the site. That alone makes most components 20% cheaper in China than in the U.S., says campus General Manager Tim Dinwiddie. Plus, China will soon eliminate remaining tariffs on imported chips. In the past five years, electronic manufacturing-services companies such as Flextronics have cut their U.S. production from \$37 billion to \$27 billion while doubling their China output, to \$31 billion. That's likely to double again by 2007.



THE CHINA PRICE

LCD TV

PRICE GAP

30%

30-inch LCD TV by China's SVA sells in the U.S. for \$1,600. Philips' comparable set goes for \$2,000.

Data: SVA America

For the price of one U.S. engineer, the joint venture can throw four engineers into the task of making customized products for a client. Even if 3Com does not succeed, similar tie-ups are expected, which could drive down prices of high-end goods sold in the U.S. Says 3Com President Bruce Claflin, "We want to change the pricing structure of the industry." 3Com hopes this is the start of a whole line of networking gear designed and made in China for the global market. Without referring to China, Cisco CEO John T. Chambers says "we are starting to see a stream of good, very price-competitive competitors, particular from Asia."

The next step for China is critical mass in core industries. Outside Beijing, Semiconductor Manufacturing International Corp. has just opened a chip plant fabricating 12-inch silicon wafers that experts say is just two generations behind Intel Corp. A foundry that makes chips on a contract basis, this plant won't compete directly with U.S. chipmakers. But with four more 12-inch wafer plants due by 2006 and many more fabs in the pipeline, the U.S. Semiconductor Industry Association warns that a "gravitational pull" could suck capital, people, and leading-edge research-and-development and design functions from the U.S.

Digital technologies aren't the only areas where the Chinese have huge ambitions. In the past decade, U.S. petrochemical makers have invested in little new capacity. But at a three-mile long site in Nanjing, 12,000 workers are erecting a \$2.7 billion network of pipes and towers for China's Sinopec and Germany's BASF that by next year will be among the world's biggest, most modern complexes for ethylene, the basic ingredient in plastics. An even bigger complex is going up in Shanghai. "The Chinese understand everything that scale means," says Fluor Corp. Group President Robert McNamara, who lives part-time in Shanghai and whose company has design contracts.

"Gravitational Pull"

CHINA IS EVEN MAKING its presence felt in the U.S. market for networking gear, a bastion of American comparative advantage. On Nov. 15, struggling 3Com Corp. in Marlborough, Mass., launched a data-communications switching system for corporate networks of 10,000 users or more. It claims twice the performance of Cisco Systems Inc.'s comparable switch. At \$183,000, 3Com's list price is 25% less. Its secret? 3Com is settling for lower margins and taking advantage of a 1,200-engineer joint venture with China telecom giant Huawei Technologies Co. This is the first high-end piece of networking gear sold by a U.S. company that is designed and manufactured in China.

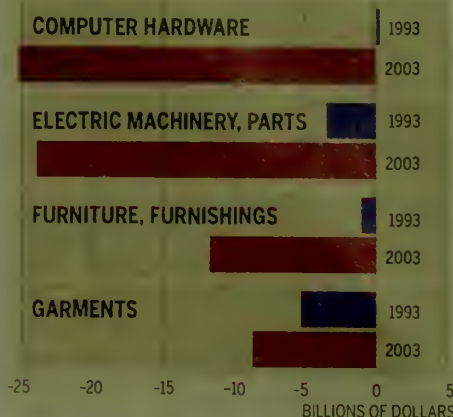
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AN UNBALANCED TRADE BALANCE

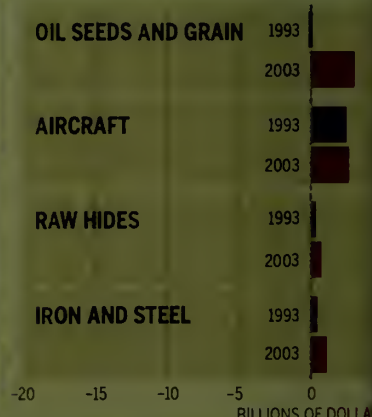
The U.S. has a growing deficit with China in most industrial categories—even in sectors where it is considered competitive. The U.S. mainly has trade surpluses in commodities such as iron and oil seeds. Some examples:

Where the U.S. has big deficits...

...and smaller surpluses



HANGZHOU The 3Com/Huawei joint venture



Data: U.S. Commerce Dept

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NANJING Sinopec and BASF's ethylene plant will be among the world's biggest

cess to overseas markets," says Chairman L Guanqiu.

Some U.S. manufacturers hope China will run

out of steam. This year, factories in Guangdong and Fujian faced serious labor shortages for the first time. Red-hot demand has meant skyrocketing costs for China's producers, most of which rely on imported goods such as steel, plastics, and components. Energy shortages have forced manufacturers to shut factories several times a week. In almost any industry one can think of, vicious price wars are biting into already razor-sharp margins. "There are so many small companies competing that they crowd out all profit," says Beijing University economist Zhang Weiyong. Indeed, given the low emphasis on profits and the unsophisticated accounting of many Chinese companies, often their pricing isn't based on a full understanding of costs. Having gotten as far

tracts at both complexes. "When they target an industry to dominate, they don't mitigate."

Can China dominate everything? Of course not. America remains the world's biggest manufacturer, producing 75% of what it consumes, though that's down from 90% in the mid-'90s. Industries requiring huge R&D budgets and capital investment, such as aerospace, pharmaceuticals, and cars, still have strong

they can on cheap production costs, Chinese manufacturers must develop their own technologies and innovative products to move ahead—areas in which they've made slow progress so far.

The juggernaut will slow, but only slightly. While salaries for top Chinese designers are rising fast, they are still a fifth to tenth of those in Silicon Valley. If China's wages rise 8% annually for the next five years, says a Boston Consulting Group

Honda and Nissan plan to export cars from China

bases in the U.S. "I don't see China becoming a major car exporter in the foreseeable future," says GM China Chairman Philip F. Murtaugh. "There is no economic rationale." Murtaugh cites high production costs and quality issues at Chinese car plants, as well as just-in-time delivery needs in the West, as impediments.

Burning Rubber

DON'T TELL THAT TO Miao Wei, president of Dongfeng Motor Corp. On Nov. 7, Dongfeng and Honda Motor Co. announced that their joint venture will invest \$340 million to boost output of Honda CR-Vs and Civics fivefold, to 120,000, by early 2006. The plant aims to achieve world standards by employing Honda's flexible manufacturing system. "Honda will sell some of the Chinese-built cars in Europe," says Miao. Nissan Motor Co. is also talking about exporting with Dongfeng.

China's carmakers are developing the suppliers that one day could sustain exports. Auto-parts maker Wanxiang Group in Hangzhou started as a tiny township-owned farm-machinery shop in 1969. Now it's a \$2.4 billion conglomerate that supplies the Chinese assembly plants of GM, Ford Motor, Volkswagen, and others and also exports 30% of its output. In two years, China will drop the rule that its auto plants buy at least 40% of parts locally. Wanxiang is getting ready: It is opening a \$42 million plant loaded with U.S. and European testing gear. And since 1995, Wanxiang has bought 10 U.S. auto-parts makers. "Our goal is to acquire technology, management, and most important, to get ac-

study, the average factory hand will still earn just \$1.30 an hour by then. If China allowed the yuan to appreciate by around 10% in the next year, productivity gains would more than offset the higher costs, figures China expert Nicholas R. Lardy of the Institute for International Economics. "I don't think revaluation will have a significant impact," he says.

And Chinese producers are hardly standing still. In a recent survey of Chinese and U.S. manufacturers by *IndustryWeek* and Cleveland-based Manufacturing Performance Institute, 54% of Chinese companies cited innovation as one of their top objectives, while only 26% of U.S. respondents did. Chinese companies spend more on worker training and enterprise management software. And 91% of U.S. plants are more than a decade old, vs. 54% in China. Shanghai-based TV maker SVA Group, for example, has opened China's first plant to make flat panels, a venture with Japan's NEC Corp. That is enabling SVA to secure a U.S. beachhead by selling liquid-crystal display and plasma TV sets through channels such as the online sites of Costco Wholesale and Target. Starting price: \$1,600—30% below similar models by Royal Philips Electronics and Panasonic.

More innovation. Better goods. Lower prices. Newer plants. America will surely continue to benefit from China's expansion. But unless it can deal with the industrial challenge, it will suffer a loss of economic power and influence. Can America afford the China price? It's the question U.S. workers, executives, and policymakers urgently need to ask. ■

—With Brian Bremner in Beijing and bureau reports



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COMMENTARY

BY PAUL MAGNUSSON

How to Level the Playing Field

Here are some steps that could help the U.S. shrink its trade deficit with China

CHINA, SAYS former U.S. Trade Representative Charlene Barshefsky, "is a tiger on steroids." So how do you live with the tiger? That question will become increasingly urgent as the Chinese-U.S. economic relationship deepens. Something has to be done to rein in ever-rising deficits without retreating from America's free-trade principles. Both sides have to give something. Here are suggested steps:

GET THE U.S. FINANCIAL HOUSE IN ORDER. Americans need to save much more so they aren't relying on foreign lending to fund the federal government and to satisfy their huge craving for imports. In the fiscal year just ended, the U.S. government ran up a \$413 billion budget shortfall. The current account, the broadest measure of trade and investment and capital flows, is headed for a \$620 billion deficit this year. That means foreigners are essentially lending America nearly \$1.7 billion a day to support its lifestyle. Much of that shortfall is being covered by the governments of China, Japan, and other Asian countries in the form of purchases of U.S. Treasuries. Naturally it's increasingly difficult for Washington to bargain on tough trade issues when it is also going begging to its trading partners for one more loan.

TRY FRESH TACTICS ON THE YUAN. The U.S. has asked Beijing to let its undervalued currency strengthen and so reduce China's advantage in exports. China insists its banking system is too fragile to let the yuan float freely, as the U.S. advises. Nor will the U.S. get the 30% revaluation that some say would have a major impact on Chinese exports. But Washington could press for a substantial adjustment. Morris Goldstein and Nicholas R. Lardy of the Institute for International Economics suggest the yuan could trade 15% higher with no damage to China's banking system. That would be a start. It would also help persuade Japan and other Asian nations that are big contributors to the U.S. deficit to let their currencies rise. If China refuses? Take the issue to the World Trade Organization. Its rules prohibit countries from manipulating their currencies to secure a trade advantage.

ENFORCE TRADE LAW MORE AGGRESSIVELY. The U.S. relies far too much on anti-dumping suits filed by American companies

to level the playing field. The process is costly for small companies in particular and takes years, by which time the damage is done because Chinese producers move so fast into markets. The U.S. Commerce Dept. can file suits on its own when it sees industries under attack. Commerce used this tactic successfully with Japanese chipmakers in the 1980s. It could use it again, especially if China started to dump goods in key industries such as auto parts, stainless steel, and specialty chemicals. The U.S. can also be more aggressive in seeking WTO action. China backed down, for example, from applying higher taxes on imported semiconductors after the U.S. threatened to take the issue to the WTO.

BEEF UP DEFENSE OF INTELLECTUAL PROPERTY. Software is something the U.S. should be exporting in huge volumes. China, one of the world's biggest growth markets for computers. Yet the U.S. Business Software Alliance estimates that 92% of all software in Chinese computers is either unlicensed or pirated. That represents a loss to U.S. exporters of some \$3.8 billion a year. Stolen software also helps subsidize Chinese engineering companies, machine toolmakers, and other industries that don't have to pay the licensing fees their U.S. competitors do. And it's not just software. Counterfeit pharmaceuticals and even fertilizers are joining the roster of pirated music CDs, books, movies, and video games. Beijing has brought some high-profile criminal cases. But in general it emphasizes small civil penalties that pirates shrug off. The U.S. has now mainly jawboned China to do better. But Washington could bring the issue to the WTO and could seek sanctions for future violations.

REOPEN THE WTO DEAL. When the agreement to let China into the WTO was negotiated, China was allowed to continue to protect certain strategic industries under the rationale that it was a developing nation. Even though China is lowering tariffs, duties remain high by global standards in some industries. Foreign companies are still compelled to manufacture locally and form joint ventures in car, telecom, and construction and engineering services—are where America could be exporting. Beijing has been able to restrict the right of foreign companies to distribute with China on their own and is resisting opening up government contracts to foreign bidding. But China is growing up quickly and no longer needs these protections to stand on its feet. The U.S. has leverage as well. China is eager to have its "non-market economy" status upgraded. For complex reasons, that would make it easier for China to defend itself against anti-dumping cases. The U.S. could back that upgrade in status return for a renegotiated WTO deal. ■

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the yuan
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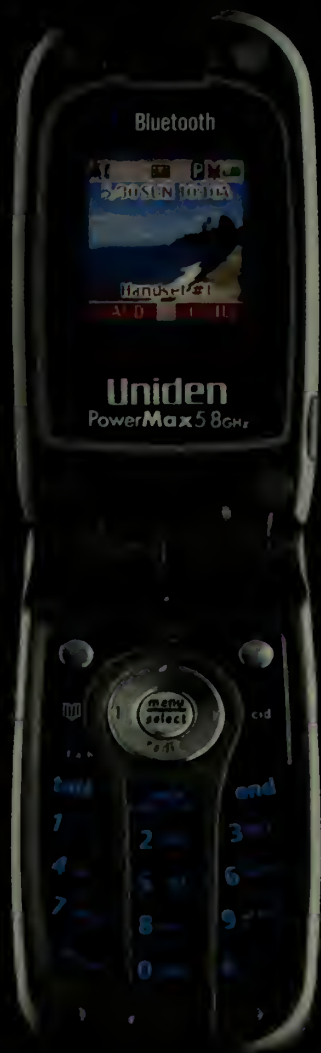


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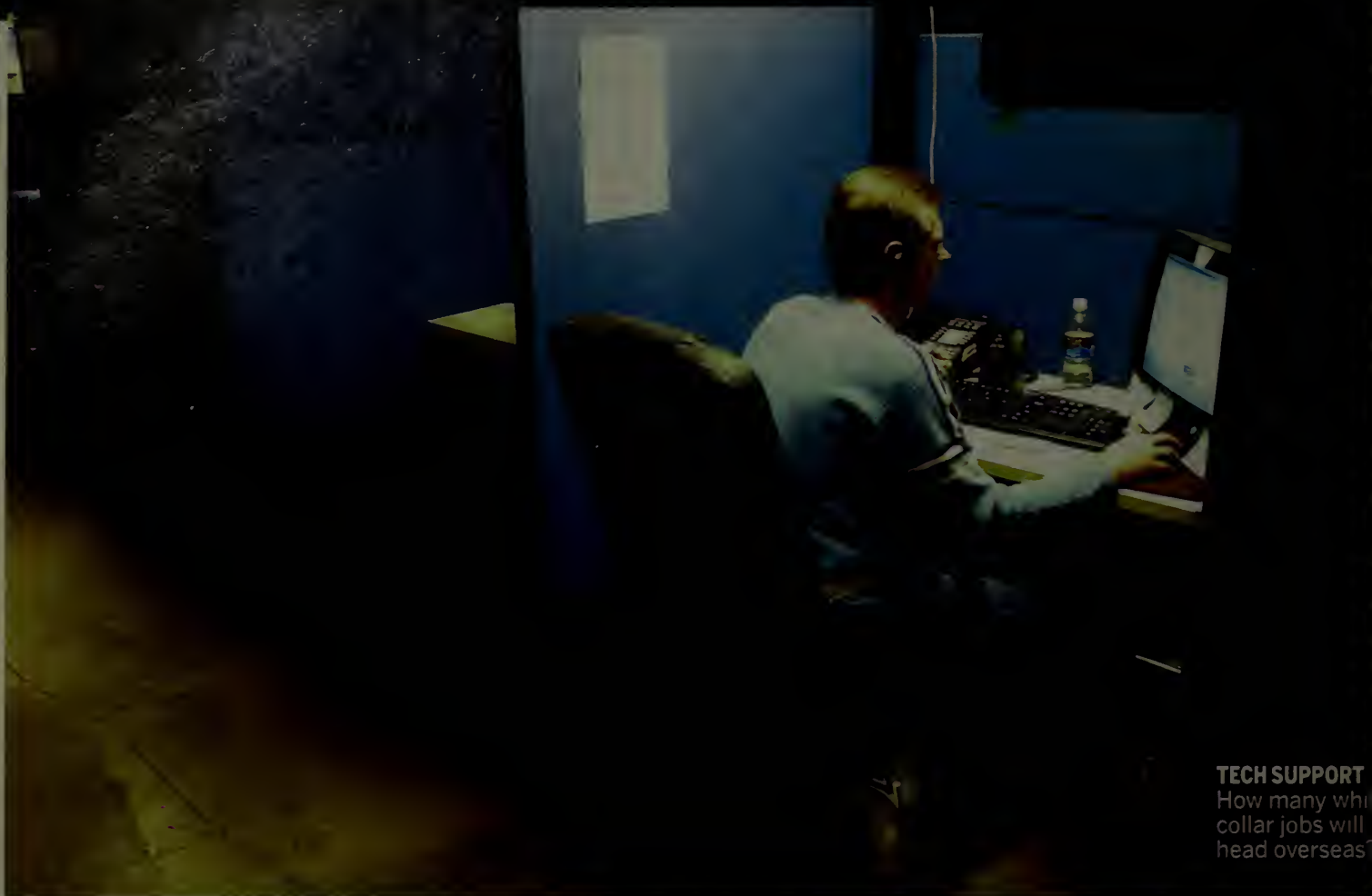


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TECH SUPPORT

How many white-collar jobs will head overseas?

SHAKING UP TRADE THEORY

For decades economists have insisted that the U.S. wins from globalization. Now they're not so sure. **BY AARON BERNSTEIN**

EVER SINCE AMERICANS BEGAN FRETTING about globalization nearly three decades ago, economists have patiently explained why, on balance, it's a boon to the U.S. Yes, some Americans lose their jobs, either to imports or because factories move to cheap-labor countries such as China or India. But the bulk of this work is labor-intensive and lower skilled and can be done more efficiently by countries that have an abundance of less-educated workers. In return, those countries buy more of our higher-value goods made by skilled workers—for which the U.S. has a comparative advantage. The lost jobs and lower wages in the U.S., economists say, are more than offset when countries specialize like this, leading

to more robust exports and lower prices on imported goods.

Now this long-held consensus is beginning to crack. True, China is emerging as a global powerhouse, realigning many economic relationships. But in the long run a more disruptive trend may be the fast-rising tide of white-collar jobs shifting to cheap-labor countries. The fact that programming, engineering, and other high-skilled jobs are jumping to places such as China and India seems to conflict head-on with the 200-year-old doctrine of comparative advantage. With these countries now graduating more college students than the U.S. every year, economists are increasingly uncertain about just where the U.S. has an advantage anymore—or whether the standard framework for understanding globalization still applies in the face of so-called white-collar offshoring. “Now we’ve got trade pa

...rns that challenge the common view of trade theory, which might not be so true anymore," says Gary C. Hufbauer, a senior fellow at the Institute for International Economics (IIE), a Washington (D.C.) think tank. A leading advocate of free-trade acts, he still thinks white-collar job shifts are good for the U.S.

The great debate percolating among the country's top trade economists gained new prominence with a recent article by Nobel laureate Paul A. Samuelson in the *Journal of Economic Perspectives* (JEP). In the piece, the 89-year-old professor emeritus at Massachusetts Institute of Technology, who largely invented much of modern-day economics, questions whether rising mills in China and India necessarily will benefit the U.S.

The reaction was swift. Experts such as Columbia University trade economist Jagdish N. Bhagwati, who countered Samuelson in the next JEP issue, resist the notion that the new offshoring could lower U.S. wages or slow growth of gross domestic product. After all, these economists have spent their professional lives ridiculing such conclusions as so much protectionist nonsense. Nevertheless, they aren't yet able to reconcile what's happening on the ground with the ideas they have so passionately defended. "This is a whole unexplored question that is very controversial, and nobody has a clue about what the numbers are," says Robert C. Feenstra, a prominent trade economist at the University of California at Davis.

Global Labor Pool

THE CENTRAL QUESTION Samuelson and others raise is whether unfettered trade is always still as good for the U.S. as they have long believed. Ever since British economist David Ricardo spelled out the theory of comparative advantage in the early 1800s, most economists have concluded that countries gain more than they lose when they trade with each other and specialize in what they do best. Today, however, advances in telecommunications such as broadband and the Internet have led to a new type of trade that doesn't fit neatly into the theory. Now that brainpower can zip around the world at low cost, a global labor market for skilled workers seems to be emerging for the first time—and has the potential to upset traditional notions of national specialization.

There are three ways this new development could disrupt the U.S. economy. If enough cheap, high-skilled workers become available around the world, competition may drive down U.S. wages for a wide swath of white-collar workers. Even economists who still see overall net gains agree that this is a potential problem. "For the first time, high-skilled U.S. workers are going to be exposed to international competition, though it's not clear how much it will hurt their wages," says Bhagwati.

A second concern is how much of the gains from trade will



flow through to U.S. consumers. Until now the pain of globalization has been borne by less than a quarter of the workforce, mostly lower-skilled workers, whose wage cuts outweighed the cheaper-priced goods globalization brings. But the other three-quarters of American workers still came out ahead, since they weren't affected by foreign wage competition. If blue- and white-collar employees alike are thrown into the global labor pool, a majority of workers could end up losing more than they gain in lower prices. Then the benefits of increased trade would go primarily to employers. "It's entirely possible that all workers will lose and shareholders will gain; you have to be concerned about that," says Harvard University trade economist Dani Rodrik.

BANGALORE Tech-services outsourcing is on the rise

Even that wouldn't be enough to completely derail comparative-advantage theory, which holds that higher profits from trade should more than offset the lower wages. But again, for the first time, economists see another factor at play. As skill levels improve in cheap-labor countries—for example, the new engineering class in India—competition is coming on in the very products for which the U.S. has had a global advantage, such as software. If the new

WHEN WHITE-COLLAR JOBS GO ABROAD

Trade economists are struggling to reconcile traditional theories with emerging global realities. Three new worries:

HIGH-SKILL WAGE SLIDE

The development of a global market for white-collar workers could undercut the wages of highly skilled Americans for the first time

COMPANIES TAKE ALL

If globalization cuts pay for both white- and blue-collar workers, a majority of the U.S. workforce could lose out, leaving employers and shareholders as the prime beneficiaries

A BLOW TO GDP GROWTH

If cheaper white-collar labor slashes the prices of exports in which the U.S. has a comparative advantage, such as software, the economy overall could suffer

“Comparative advantage cannot be counted on to create...net gains greater than the net losses from trade” —PAUL SAMUELSON, Massachusetts Institute of Technology



competition drives down prices too much, U.S. export earnings will suffer, and the entire U.S. economy could end up worse off.

While experts such as Hufbauer and Bhagwati doubt it will ever come to this, the fact that they're even entertaining such concepts is an intellectual sea change on a subject long considered settled. When countries such as China can perform tasks in which the U.S. previously had a clear edge, “comparative advantage cannot be counted on to create...net gains greater than the net losses,” Samuelson asserts in his new paper.

The rethinking among economists could soon spill over into

the policy arena. No one is advocating new trade barriers which could be a cure that's worse than the disease. Nonetheless, the shaken views of so many prominent economists could prove to be critical. Throughout the 1990s, Washington embraced new trade deals in large part because of the virtual unanimity among experts that trade always benefits the U.S. They're not so sure anymore, the public consensus that was unsteady to begin with could start to unravel.

Two tests will come next year when U.S. membership in the World Trade Organization comes up for review, as does the President's so-called fast-track authority to negotiate trade agreements. “I'm worried that rising anxiety among highly skilled workers will erode support for continued globalization in the U.S.,” says Dartmouth University economics professor Matthew J. Slaughter.

HOW MUCH PAIN?

As more U.S. employers embrace white-collar globalization...

SHARE OF 1,000 LARGEST U.S. COMPANIES THAT SAY THEY PLAN TO:	2003	2008
Do virtually no white-collar offshoring	63%	46%
Offshore to some degree	33	44
Offshore any white-collar work possible	4	10

Data: Forrester Research Inc.

...more nonfactory jobs will move abroad

	2002 employment*	SHARE MOVING OFFSHORE BY**		
		2004	2008	2015
Computer	3 million	5%	9%	20%
Legal	1	1	3	9
Business	5	1	3	8
Architecture	2	1	2	8
Office	23	1	3	7
Life sciences	1	0	1	4
Management	7	0	1	4
Art, Design	2	0	1	2
Sales	13	0	0	2
Total	57 million jobs	1%, or 546,000 jobs	2%, or 1.2 million jobs	6%, or 3.4 million jobs

Data: Forrester Research Inc. **estimates

...biting into American wages

U.S. JOB DISPLACEMENT* FROM 1979 TO 2001

68% of job-losers found new work within three years...	...but their average wage declined 10%
44% of those re-employed earned less at their new job...	...and their average wage dropped 49%

*Data for 1979-2001 were used for performance reasons. Data for 2002-2003 were estimated by the author.

“A Right to Be Scared”

HOW LARGE MIGHT THE white-collar offshoring trend become? The more jobs that go, the greater the impact on U.S. wages. Consultant Forrester Research Inc. in Cambridge, Mass., was among the first to spot the white-collar job shifts and has done the most detailed projections so far. It sees the pace of U.S. job flows abroad averaging 300,000 a year through 2015. That is probably conservative since Forrester has also found that the number of U.S. companies among the 1,000 largest that engage in some level of white-collar offshoring will rise sharply—from 37% today to 54% by 2008. Already, some 14 million white-collar jobs involve work that can be shipped electronically and thus in theory could be moved offshore, according to a study by economists Ashok D. Bardhan and Cynthia A. Kroll at the University of California at Berkeley's Haas School of Business.

The hit to wages could be powerful if that happens. Forrester analyst John C. McCarthy identified 242 service jobs as likely to be affected among the 500-plus major occupations tracked by the Bureau of Labor Statistics (BLS). He ranked each by the share of jobs employers are likely to shift abroad by 2015. His conclusion: The cumulative job outflow will total 3.4 million over that period. That comes to 6% of the 57 million people who work in these 242 occupations today.

If that's in the ballpark, U.S. white-collar wages would get whacked, says Harvard University labor economist Lawrence Katz. Every 1% drop in employment due to imports or factories gone abroad shaves 0.5% off pay for remaining workers, he found in a study with Harvard colleagues Richard B. Freeman and George J. Borjas. So if job losses rise to 6% of the white-collar total, these workers' pay could be depressed by 2% to 3% through 2015, figures Katz. While a few percentage points over a decade or so may not sound dire, it's roughly as much as blue-collar workers lost to globalization in recent decades. “White-collar workers have a right to be scared,” says Katz.

Another way economists gauge the potential wage impact is to look at examples of how people fare when they lose a job and extrapolate for those who might get displaced by offshoring. Turns out that just 30% of laid-off workers earn the same or

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more after three years, according to a study of 22 years of BLS data by economics professor Lori G. Kletzer of the University of California at Santa Cruz. Only 68% even hold a job at that point, while the rest are unemployed, retired, or perhaps at home with children. On average, those reemployed earn 10% less than before, Kletzer found. "Clearly, offshoring will be bad for U.S. wages, given what the job displacement numbers tell us," says Princeton University economics professor Henry S. Farber, who has written extensively about displaced workers.

But even if the incomes of more U.S. workers fall, won't the rest of American consumers benefit from the lower-priced goods and services globalization brings? Not necessarily, some economists now believe. Most studies of trade's impact on pay, including Katz's, assume that factory-job losses simply shift the demand for labor from one kind of worker to another higher up

“There will be specialization within industries [which will bring] a lot of demand...for our higher skills”

—JAGDISH BHAGWATI, Columbia University

the value chain. So higher-educated workers gained much of what the less-schooled lost.

But if white-collar offshoring swells enough, the resulting job losses could undercut a large swath of U.S. consumers. In part, this is a question of scale. There's little doubt that globalization is likely to continue to cut into the country's 14.5 million factory hands. Add in 57 million white-collar workers suddenly facing global competition, too, and more than half the U.S. workforce of 130 million could feel the impact. Then, economists conclude, the benefits of globalization would flow mostly to companies and shareholders who profit from the cheaper labor, with little pass-through to workers and consumers. "If a majority of Americans have lower wages from outsourcing, then capital would be the prime beneficiary, even if U.S. GDP goes up," says Harvard's Freeman.

Domestic Disturbance

COULD THE OFFSHORE PHENOMENON even dent America's overall GDP? Standard theory suggests not, but it's now another question nagging economists. Ricardo's insight that all countries come out ahead when they trade more with each other was updated in the early 1900s by two Swedish economists, Eli F. Hecksher and Bertil Olin. They showed that Ricardo's idea holds even if high-skilled countries such as the U.S. trade more with low-skilled ones such as India, with each country specializing in products in which they have a relative advantage. Thus, it's more efficient for the U.S., where about 60% of the workforce has some college education, to export products that use their skills and import low-end ones from cheap-labor countries. Conversely, India, where just a fraction of its 400 million-plus workers have gone to college, should grab the low-skilled work and leave higher-end products to the U.S.

This theory doesn't square with today's outflows of programming and other higher-skilled jobs. "According to the Hecksher-Olin model, we shouldn't be sending these jobs to countries with [so few skilled workers]," says University of California at Los Angeles trade economist Edward E. Leamer. But U.S. companies are doing just that because labor is cheaper and the Net

makes it feasible to transport work done abroad back to the U.S.

Still, most economists think the new offshoring is an overall plus. For one thing, they say, employers' cost savings should more than compensate for any wage damage. And by slashing the price of software and other goods, offshoring could power a new wave of U.S. productivity gains similar to those triggered by falling computer-hardware prices in the '90s, says a study by Hufbauer's colleague, IIE senior fellow Catherine L. Mann.

She and others argue that countries will continue to specialize in what they do best. Sure, India or China are taking high-skilled jobs in programming, but the U.S. will still outperform them in, perhaps, drug research or nanotechnology. Instead of thinking about comparative advantage in broad strokes such as high-skilled and low-skilled, they say, it makes more sense to make finer distinctions and look at areas in which countries

have industry- or occupation-specific advantages. "There will be specialization within industries, [which will bring] a lot of demand from India for our higher skills," says Bhagwati.

Other economists, however, such as Leamer and Rodrik, believe that in the new global economy, advantages from these kinds of micro-level specialties will be fleeting. After all, if the U.S. is better at aerospace research, there's no reason why China couldn't quickly ramp up college grads in that area, too. It's already doing that in telecom and servers.



Leamer and other trade experts say the resulting price competition from rising stars such as China and India could overpower any economywide gains companies get from global sourcing. They point to a famous 1968 paper by, of all people, Bhagwati, who argued that a country can be made worse off if trade lowers the price of products in which it has a comparative advantage. Bhagwati called it the "immiserating effects of trade." In discussing the idea with *BusinessWeek*, Leamer wrote a short proof showing how a downward spiral of lower labor costs leads to lower export prices, causing immiseration. Even Bhagwati concedes that his insight could apply to the U.S. today, though he thinks the chances are slim that it will. "Bhagwati showed back then that a country can grow and get poorer, which might be this story, though I doubt it," says Hufbauer.

Indeed, it's possible that the U.S. already has suffered immiseration. Mann's study found that the offshore exodus of U.S. chip factories accounted for 10% to 30% of the decline in the prices of personal computers and memory chips in the early 1990s. These savings boosted U.S. multinationals' net export of these products, and by 2000 the companies saw a \$10 billion trade surplus in them.

But did the U.S. as a whole come out ahead? Mann's study also shows that the country's overall trade deficit in these products plunged into negative territory in 1992 and has remained there ever since. So while large U.S. companies gained from moving chip factories abroad, the overall U.S. economy may have lost. "This looks like immiseration to me," says Leamer.

Globalization, say most trade economists, ultimately should benefit the U.S. more than it hurts. But they can't yet show that to be true. Until someone comes up with a convincing explanation for what happens when the highest-skilled jobs move offshore, battles over globalization are likely to rage even hotter. ■

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COMMENTARY

BY MICHAEL J. MANDEL

Does It Matter If China Catches up to the U.S.?

History says it won't—if political stability allows trade to flow freely

THE SPECTACULAR rise of China—and to a lesser extent, India—is one of the great events in economic history. If the current rate of expansion continues, in a mere 10 years China will be the largest economy, followed by the U.S. and India. The last time the world economic order was so dramatically transformed, the U.S. was the muscular newcomer. In 1820 the

collection of former British colonies had a significantly smaller economy than any of the leading European countries. In 1913, on the eve of World War I, the U.S. was the clear global leader, with double the output of its nearest rival.

Looking back, the explosive growth of the U.S. carries two lessons for today. First, the rise of a new economic power can help lift the entire global economy. From 1820 to 1913 the average income in Western Europe rose almost as fast as in America. There was an easy flow of goods, capital, and ideas across national borders. Innovations that originated in the U.S., such as the telephone, were quickly picked up on the other side of the Atlantic, while other technologies, such as the internal combustion engine, made their first appearance in Europe and spread back to the U.S. In brief, global trade and technological progress was a win-win proposition, not a zero-sum game.

But post-1913 history yields a second, equally important message: The benefits of trade are vulnerable to political and financial turmoil. Europe and the U.S. could prosper together only as long as the global trade and financial system was humming. First the Continent was devastated by the two world wars. Then high tariffs and national hostility fragmented

European markets while impeding the adoption of new U.S. production techniques such as Henry Ford's assembly lines for autos. The result: The U.S. leaped ahead economically. In 1913 per capita incomes in the U.S. and Britain were roughly equal. By 1950 the U.S. standard of living was almost 40% higher.

Of course there are many differences between the U.S. of the 1800s and China today. For one, China's rise is more spectacular, with per-capita gross domestic product increasing about 8% per year for the past 25 years. By comparison, the strongest average per-capita growth for the U.S. for any 25-year period since 1830 was less than 4% per year. Moreover, China has built its success on its export machine while the U.S. thrived mainly because of its vibrant domestic market.

The past does illuminate what can happen when a new economic superpower enters the scene. From 1820 to 1913, as America rose to economic preeminence, GDP per person rose at an average rate of about 1.5% per year—enough to quadruple real incomes for the average American. But that didn't come at Europe's expense. Over this stretch GDP per capita in Britain, France, and Germany rose at roughly a 1.1%-to-1.3% annual av-

TEAMWORK The first transatlantic cable was a U.S.-British joint venture





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FORD MODEL T As the U.S. auto biz boomed, turmoil in Europe held the Continent back

erage pace. That was slower than in the U.S., but it was enough to triple real incomes in those countries.

Part of what fueled these gains was the ability of Europe and the U.S. to feed off each other's technological advances, boosting global growth. The first successful transatlantic telegraph cable laid in 1866 was, for example, a joint venture of U.S. and British investors. The telephone was invented in Boston by Alexander Graham Bell in March, 1876. It was first exhibited in Britain a mere six months later, and the first British phone company was started in 1878. Similarly, Thomas A. Edison opened up the first permanent electric power station in the U.S. in New York in September, 1882. But eight months before that, Edison had started operating an electric power station in London.

So Far So Good

THE CLOSE LINKS BETWEEN the U.S. and Europe fostered growth in both regions then, but how is trade affecting the U.S. today? Just as Europe prospered in the 1800s despite the rise of America, the U.S. is faring relatively well now, in a world where manufacturing jobs are moving in droves to China and white-collar jobs are outsourced to India. GDP per person in the U.S., adjusted for inflation, is up 6% since 2000 despite a recession, the terrorist attacks of September 11, 2001, and a massive trade deficit that is subtracted from GDP.

Surprisingly, real wages are up as well, as inexpensive goods from China hold down inflation and help paychecks go further.

The U.S. is more vulnerable to any blow to shipping or to China's fragile banking system

According to the latest figures from the Bureau of Labor Statistics, real wages of private-sector workers are up 3.3% since 2000. At the high end, real wages rose 5.1% for managers and 3.1% for professionals despite the recession and pressure from information technology jobs transferring out of the country. At the less-skilled end, over the past four years there has been a 4.1% real wage increase for clerical and administrative support workers, a 3.2% gain for less-

skilled blue-collar workers, and a 6.7% jump for traditionally low-paid health-care workers. These are solid improvements even compared with the boom years of 1996 to 2000, when private-sector wages showed a 5.4% increase.

As for innovation, the U.S. still has a comparative advantage in key areas such as biotechnology and finance. Biotech, which many believe could fuel the next global boom, is still concentrated in the U.S. And the American financial system, far deeper and more robust than its fragile Chinese counterpart, is much better suited to be the global financial hub.

But as history shows, in periods of political, economic, or military turmoil, the free flow of goods, capital, and ideas can get choked off. And some countries feel the pain more than others. Europe found that out during World War I and the Great Depression. While America was developing mass production and a domestic automobile industry, "Europe was distracted by wars and interwar economic chaos," writes economist Robert Gordon of Northwestern University. The result: The U.S. grew while Europe stagnated. From 1913 to 1950, U.S. GDP per person rose 1.6% per year—as fast as in the previous 100 years—while Europe struggled with a meager 0.8% annual gain.

Similarly, the shift of manufacturing to China would not be a problem under ordinary circumstances. But it does make the U.S. more vulnerable to political and financial shocks to the global trading system in new ways. Those disruptions could be widespread terrorist attacks that disrupt transpacific shipping, a sudden run on the dollar that forces the Chinese central bank to stop buying Treasury bonds, or even the collapse of the Chinese banking system, which is burdened with huge amounts of

bad loans. Any of these could reduce the flow of goods from Chinese factories to the U.S.

The bottom line is in many ways a simple one: The ever-strengthening nexus between the U.S. and Chinese economies is a good thing for both countries—as long as trade is not interrupted. In 1914 European countries simply didn't understand how much their prosperity depended on a stable and open global trading economy. That's the mistake the U.S. cannot afford to make today. ■

A TALE OF TWO POWERS

China's rise as an economic powerhouse is reminiscent of the U.S.'s ascent last century, only it's happening faster. Here are some parallels:

	SHARE OF GLOBAL GDP			REAL GDP PER PERSON**
	1820	1913	1950	
U.S.	1.8%	18.9%	27.3%	1820-1913 1.5%
China*	1980	2004	2015	1980-2004 8.2%
	3.2%	13.0%	20.3%	

*Data from the U.S. Census Bureau. **Growth rate. Projection assumes the 2015 growth rate of the past 10 years continues. Data: U.S. Census Bureau; Economic Co-Operation & Development; International Monetary Fund; BusinessWeek.

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End of the Big Bank Bonanza

Costs for everything from upgrading branches to fighting lawsuits are spiking

THESE HAVE BEEN FLUSH times for U.S. banks. This year, they most likely will beat last year's record profits of \$120 billion—thanks to the lowest interest rates in decades and spending by indefatigable consumers, whose transactions account for two-thirds of bank revenues.

Yet the end of Easy Street may be near. Costs for everything from upgrading bank branches to fighting lawsuits and complying with tighter regulations are spiking. Technology expenses alone are rising 6% a year as the need to upgrade computer systems from past acquisitions becomes pressing. At the same time, revenues are taking a hit as interest rates edge up, hurting the mortgage-refinancing and bond-trading businesses. "Banks have seen windfall profits these last few years," says Nick Studer, head of consultant Mercer Oliver Wyman's corporate and institutional banking practice. "They're thinking that they've got a business full of good athletes, but in fact they've been running downhill."

Megamergers have bought banks growth and time before—now both are running out. "Banks have spent a lot of money to get a lot bigger, but they aren't much more efficient," says Adam Dener, author of a study called *The Emerging Crisis in U.S. Banking Profitability* and a partner at Capco, a financial services consultancy. "As a result, they now face a business model impasse."

Analysts are pruning their earnings estimates. They figure that earnings for the 1,339 companies in the Dow Jones Bank Index will grow a meager 4% this year, down from 8% six months ago, says

Thomson Financial. Next year's numbers also are being ratcheted down: On Nov. 22, Andrew B. Collins of Piper Jaffray & Co. shaved 6% off his 2005 earnings estimate for J.P. Morgan Chase & Co., while John E. McDonald of Banc of America Securities cut his forecast for Citigroup to 4% below the consensus. That may be just the beginning. "What happens if the consumer rolls over?" asks Barry F. Kroeger, deputy director of the banking and capital markets practice at Ernst & Young. Consumers "fueled the recovery, and unless banks can replace those revenues, that's going to have a huge impact on their future."

REFI RETRENCHMENT

RIISING INTEREST RATES are banks' immediate worry. Long-running predictions of the end of the mortgage-refi boom are starting to come true, big time. The Mortgage Banker's Assn. forecasts refi activity will fall 55% this year, to \$1.15 trillion.

Obstacle Course

Banks are facing hurdles in their quest to boost earnings. Here's why:

- They're investing heavily in technology, but the payoff in increased productivity is years off
- Hedge and private-equity funds are encroaching on the banks' commercial loan business
- The hot credit-card and mortgage-refi businesses are cooling as interest rates rise
- Regulatory costs are rising because of new laws, and legal costs are soaring as more customers and shareholders sue

And higher rates could soon push depositors to move their cash elsewhere, robbing banks of cheap funding, says Capco's Dener. Bond trading, another huge profit center for banks as interest rates swooned, is also set to plummet. Banc of America analyst McDonald expects that Citi's fixed-income trading revenues will fall 8% next year—a \$681 million decline.

Meanwhile, corporations are so flush with cash that commercial lending has remained flat even despite the improved economy. Banks are losing out to rival private-equity firms, specialized outfits such as CIT Group Inc., and even hedge funds as the lenders of choice for small and midsize companies. The competition is stiff because borrowing by such companies—now a \$20 billion market—is growing 8% a year, twice the rate of lending to large corporations, say consultants McKinsey & Co. The banks have largely blamed themselves for their dwindling share of this market. They alienated customers by making it tougher to get loans during the recession and also ignored them while chasing larger companies that promised lucrative investment banking and other fees—businesses that turned out to be less profitable than they hoped.

In a telling sign of the lack of loan demand, U.S. Bancorp of Minneapolis announced last month that it was raising payouts to shareholders. After planning to use 80% of its \$1.1 billion third-quarter profit to pay dividends and buy back shares, the nation's sixth-largest bank upped that to 94%. With demand for commercial loan growth flat, it was the best the bank could do with the money, analysts say. "Banks can't deploy this capital because the market demand for their services is maturing," says E&Y's Kroeger.

While banks cast about for new areas of hot growth, costs keep climbing. With the advent of the U.S. Patriot Act requiring banks to set up new anti-money-laundering procedures, additional governance controls mandated by the Sarbanes-Oxley Act of 2002, and new mutual fund rules to monitor unlawful trading, compliance costs are the biggest new expense. In fact, additional non-interest expenses—a category tracked by the Federal Deposit Insurance Corp. that includes such costs—rose nearly 14%, or \$58 billion, in the first half of the year.



in tech spending by banks last year went to maintain existing systems, according to Deloitte & Touche.

PAYING LIP SERVICE

CRITICS SAY THAT money might have been better spent on new technology and training that helps to sell more products. "Banks have paid lip service to cross-selling and managing customer relationships," says Mercer's Studer, "but most haven't done anywhere nearly enough." Wells Fargo & Co. is one exception: It says its typical customer buys four products, twice the industry average. But Deloitte estimates that, overall, customer churn costs banks \$15 billion a year. And their apparent inability to engage customers means that banks scoop up just \$1,000 of the \$3,500 that the average American household spends each year on financial services.

Of course, by some measures banks are better run now than ever. Since the recession of the early 1990s, they have become adept at managing risk by using sophisticated hedges and bundling loans to sell to the capital markets. And bolstered by years of strong earnings, banks are in better financial shape than they have been for years. The huge burden of post-bubble

regulations also carry an upside: It should help banks avoid the sorts of blowups that have plagued them in the past.

If banks want to keep margins up as many of their mainstay businesses shrink, they need to squeeze more value from their operations and boost productivity.

"They have been living under this false premise that as they get bigger, they get better," says Tom Brown, chief executive of hedge-fund firm Second Curve Capital LLC in New York. "What the biggest banks haven't done is excel at the basics." First, they'd better get back to basics. ■

—By Mara Der Hovanesian in New York

The category also includes litigation reserves, which are ballooning as the number and size of lawsuits filed against banks are soaring. Italian dairy giant Parmalat, for instance, is suing Citi and Bank of America Corp. for more than \$10 billion each, claiming that they played a role in its bankruptcy. That's more than Citi's first-half pretax income of \$9.7 billion. Both banks are contesting the suit. One big bright spot is that loan losses are the lowest in memory. That, however, is leading banks to reduce reserves against future losses. CreditSights analyst David A. Hendler found that banks reduced their capital reserves by \$800 million in the third quarter, adding to earnings. But with loan losses now below historical norms, an uptick in bad loans is inevitable, he says. "If borrowing costs spike, investors should expect

sizable readjustments to credit costs," he says.

The merger wave of the last decade papered over many of these issues. Now, banks can no longer boost their earnings by simply buying another big bank. They must finally do the hard work of integrating their acquisitions to become more efficient. Many banks depend on decades-old computer systems that use archaic programming languages and pay people "astronomical salaries to keep the systems up and running," says Dan Stull, managing director of Jefferson Wells in Seattle, a financial-industry compliance specialist. "They haven't given themselves the time to merge the systems before they move on to the next deal." In fact, three-quarters of some \$340 billion

Tech budgets are going for old systems, not much-needed new efficiencies

All That Cash—and Nowhere to Go

With stocks high and volatility low, value fund managers are sitting on the sidelines

VETERAN VALUE FUND manager Robert L. Rodriguez is sitting on a wad of money. Some 36% of his \$1.6 billion FPA Capital Fund Inc. and 25% of his \$1.9 billion FPA New Income Fund Inc. are parked in cash. And Rodriguez isn't the only investor on the sidelines. With the stock market once again climbing and share valuations much higher than a year ago, a host of seasoned, price-conscious managers are piling up cash rather than buying stocks. "We're glorified money-market managers," laments Rodriguez.

So-called deep-value managers, who make a living by scouring the market for stocks selling at big discounts to what they figure the companies are worth, have the thickest wads. Big players such as the \$7.4 billion Clipper Fund, the \$8.4 billion Longleaf Partners Fund, and the \$4.3 billion Weitz Value Fund each have more than 20% in cash. A major factor behind the buildup: a lack of stock market volatility, in particular the dips that value players rely on to pick up stocks cheap. As of Nov. 23, there hasn't been a single day this year when the Standard & Poor's 500-stock index fell or rose by more than



2%. Last year the index experienced 15 such swings.

Today's high cash levels are leading some value-oriented funds into uncharted territory. Steven Romick's \$840 million FPA Crescent Fund Inc., which invests in equities and high-yield bonds, typically has about 14% in cash. Now, Romick's

cash stake has soared to 45%. That's the highest it has been since 11 years ago, when the ratio was thrown out of whack by a huge inflow of investor money in one quarter. Longleaf Partners' cash, too, is unusually high at 26%. The last time the fund approached today's cash levels was in March, 2002, when it

hit 20%. Clipper's cash hoard has doubled to 20%, since 2002.

With cash levels at some funds hitting historic highs, value managers are closing their funds to new investors rather than risk hurting their performance and current shareholders. Longleaf Partners and FPA Capital have been shut since July. Romick says he'll close his fund when assets hit about \$1 billion. "We're not going to keep taking cash ad infinitum and not put it to work."

STUCK IN NEUTRAL

INDEED, THE PICKINGS have been slim. FPA Capital's Rodriguez built a small position in furniture and appliance retail chain Rent-A-Center recently. At We

Value, analyst Bradley Hinton says the fund found a few "unique opportunities" such as drug distributor Cardinal Health during a brief pause of the summer, but he has been trimming other positions as the market has rallied. Clipper's James Gibson, who notes that there were many more underpriced stocks in 2002, thinks the market is now in a neutral period. Says Gibson: "There's a remarkable lack of reasons to buy or sell."

The bond market is providing much relief for managers who can venture outside of stocks. After hitting historic lows in late 2002, high-yield bonds look pricey, says Romick. Rodriguez echoes that sentiment. He expects the 10-year Treasury to hit 5.5% to 6% within five years—up from 4.2% now. So he is buying only short-term bonds for FPA New Income, his intermediate bond fund, to avoid a big hit from rising interest rates. The average bond in Rodriguez' fund now has a maturity of just 1.5 years.

If volatility does pick up and better values emerge, all that cash will give the value players enormous buying power. "I wish Mr. Market would get drunk and have a bad fall so that psychology and investor enthusiasm would get very depressed," says Rodriguez. "That would make us very happy campers."

He isn't banking on it, though. He believes that his cash will be higher in mid-2005. If so, he may need to settle into his role as a glorified money market manager.

—By Suzanne Woolley in New York

Getting Picky

Value-oriented mutual fund managers are stockpiling huge amounts of cash because they don't see many good buys

FUND	% OF HOLDINGS IN CASH*
FPA Crescent	45%
FPA Capital	36
Longleaf Partners	26
Weitz Value	25
Clipper Fund	20
Standard & Poor's 500	4.5%

* As of Sept. 30. Source: Morningstar, the funds

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CAUTIOUS

Saunders nailed lending to high-risk customers



Providian's Makeover Artist

Joe Saunders has remade the subprime credit-card issuer. Is it takeover bait?

WHEN PROVIDIAN Financial Corp. hired Joseph W. Saunders as chief executive in November, 2001, many investors didn't think the San Francisco credit-card company would last another year. Once the fifth-largest U.S. card issuer, Providian had begun to unravel that fall. Its strategy of handing out plastic to risky customers backfired when the recession led to big loan losses and the resignation of its chairman and CEO. "The capital structure of the business was abysmal," Saunders says. "We didn't have the financial underpinnings to survive."

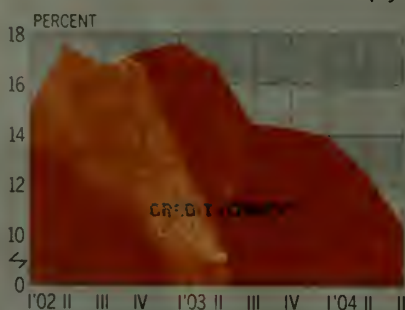
Working with regulators and a new management team, Saunders devised a three-year plan to transform Providian into a smaller but sounder organization. Avoiding subprime customers, the company now targets people with at least average credit, and has cut its credit loss rate to 10% of its outstanding loans from a peak of 18% in 2002. That's still high:

The average for the industry is just 6%, according to Moody's Investors Service. "We're three-quarters of the way across the English Channel, and we know that if we stop swimming, we'll drown," Saunders says.

In its fourth year under Saunders, Providian is looking fit enough to make it all the way. Since the first quarter, Providian's

CREDIT REPAIR

Since Joseph Saunders arrived at Providian, credit losses have fallen sharply



*AS A PERCENTAGE OF OUTSTANDING LOANS
Data: Providian Financial Corp.

an's receivables are up 7%, to \$18 billion—the first rise in three years. Richard B. Shane Jr., an analyst at Jeffries & Co., expects the company to earn \$361 million this year—its biggest profit since 2000—on revenue of \$3.65 billion. What's more, Standard & Poor's recently raised its outlook on Providian's credit from stable to positive. And the stock has risen smartly from a low of \$2.01 three years ago to around \$16 now.

BETTING ON A SALE

THESE DAYS, SAUNDERS, a 58-year-old former credit-card chief at FleetBoston Financial Corp. and Household International, often fields a pointed question: Providian for sale? He plays down the possibility the company may be acquired, but most analysts say it's a foregone conclusion. "I don't think they're going to be around in six months, let alone a year," says David Robertson, publisher of *The Nilson Report*, an industry newsletter.

The list of possible buyers is long. Near the top is British bank Barclays PLC, which bought Providian's British business for \$500 million in 2002 and, according to analysts, was negotiating to buy the rest of Providian in February. Talks broke down over the undisclosed price, but a deal could yet be done. J.P. Morgan Chase & Co., which bought \$2.5 billion in loans from Providian in 2002, is a possible acquirer, as is Citigroup. None of the companies would comment.

A sale would solve a nagging funding problem for Providian. To finance more loans, it issues securities backed by existing loans. But demand for the loans can be fickle. As part of a financial-services powerhouse, Providian would be able to tap capital in both good times and bad. "It's inevitable that independent subprime credit-card companies will become part of diversified organizations," says Thomas K. Brown, chief executive of New York hedge fund Second Curve Capital LLC. He's betting on a sale: As of June 30, his fund owned 4.9 million Providian shares.

But Saunders doesn't act like a man about to sell his company. Instead, he's exploring ways of diversifying the business. One possibility: linking up with other companies to offer mortgages and home-equity loans. And on Oct. 19, Saunders renewed his contract, due to expire at the end of this year, through 2007. As the financial picture brightens, Providian can afford to bide its time. Every quarter of improved results makes it stronger—and raises its price tag. ■

—By Justin Hibbard in San Mateo, Calif.



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RED-HOT Gulbis makes more from sponsors than she does from golf

She Can Swing A Club, Too

Natalie Gulbis' sexy photo spreads are ruffling feathers in golf

WITH RARE EXCEPTIONS, the ladies of the Ladies Professional Golf Assn. Tour are not the sort of half-dressed hotties who fill the pages of laddie magazines. Then there's Natalie Gulbis. The 21-year-old tour pro steams up the November issue of *FHM* magazine with a photo spread that includes outfits seldom seen on the greens and an interview that poses such burning long-game questions as: "Can you tell anything about a guy by the length of his drive?"

Gulbis' decision to pose for *FHM* wasn't one she came to alone, however. A PR firm, retained by the LPGA, aided in soliciting the shoot, as it did an offer for Gulbis to appear on Howard Stern's radio gabfest. (Gulbis turned that one down.) "As our players become recognizable celebrities, more unconven-

tional media outlets are becoming interested. If Natalie is comfortable [posing in *FHM*], we're supportive of the decision" says Commissioner Ty Votaw, who has been urging players to leverage their looks and charm, as well as their swings.

FHM isn't the first place Gulbis has bared her navel for fun and profit. In July the 21-year-old golfer's calendar was pulled from souvenir shelves at the U.S. Women's Open when officials of the U.S. Golf Assn. deemed it too risqué. "I'm

BATHING BEAUTY
Gulbis in *FHM* (left)
and her calendar



wearing bathing suits and work clothes, basically. Besides the USGA haven't heard the word 'provocative' about the calendars," says Gulbis, who seems genuinely baffled by the hubbub.

Gulbis and her advisers, led by her father, John, have turned her sex appeal into one of the more impressive marketing machines on the LPGA Tour. Her deals with, among others, TaylorMade-adidas, Nike, MET-Rx, GeniSoy, and EA Sports will generate more than a half-million dollars this year, according to John.

The attention also has gained Gulbis a new cachet with fans. Her Web site, nataliegulbis.com, where visitors can join a booster club, examine her pinup portfolio or buy a calendar, has logged a half-million hits in 2004. She pockets up \$15,000 for about six corporate outings a year. And the LPGA loves to feature her for publicity purposes. This year the tour slapped her likeness, along with those of two other players, on its LPGA-sponsored race car at the Daytona 500. Not bad, considering that in three years on the LPGA tour, she hasn't won a tournament and ranked 42nd on the money list in the 2004 season, with \$277,000.

"KEEP IT CLEAN"

GULBIS, A GOLFING prodigy who grew up in Sacramento and won the California amateur title at age 14, is undeniably serious about her game. During the off-season she can spend hours in the gym and then end the workout with a five-mile run. She sweats almost as much at the court as on the green. Her swing coach, Butch Harmon, Tim Woods's former golf guru, has helped her add distance to her drives, but the analytical Gulbis isn't satisfied. She points out that she ranked a respectable 20th in birdies collected this year but still finished well down the earnings list. "That's kind of an interesting stat. It tells me I need to work harder on my short game," she says.

Her father gave the nod to the *FHM* photo shoot but was there to "keep it clean" and tasteful. "This is an athlete, an LPGA professional. We're not looking for a 'skin' type of thing," says Gulbis. "No way she's wearing underwear or a negligee. Still, some of the outfits do leave a whole lot to the imagination. With Gulbis leading the way, the LPGA seems intent on shedding its dowdy image, even if that means showing off more than a smooth putting stroke. ■

—By Mark Hyman

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INNOVATIONS

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» Remember the post-9/11 exposés about incompatible radio systems used by New York's firefighters and police? To Antonio Turgeon, CEO of TechnoConcepts, that was a call to action. His small Van Nuys (Calif.) company has a technology that can enable any two radios to talk to each other. The key is a proprietary chip that sits at the base of an antenna and instantly converts any incoming analog radio signal into digital data. Normally, that process requires a dozen or so tiny analog chips—and they can handle only one signal format, such as Bluetooth or code division multiple access (CDMA). "Our objective," says Turgeon, "is a handset that can prowl the world and convert any local wireless signal."



» Preparing environmental-impact studies on new construction or logging projects is a tedious job. But it just got a lot easier for consultants and biologists who work on such reports in California. CalBiota, a compact-disk database of the state's rare plant and animal species, can chop the time needed to prepare a study's tables and charts by 80%, says developer Michael Wood of Wood Biological Consulting in Walnut Creek, Calif. A similar CD for Colorado is in the works.



MANUFACTURING A WAY TO WELD WITHOUT THE WASTE

SPARKS SHOOTING from robot welding machines: It's an iconic image of car manufacturing. But at Ford Motor, the shower of sparks is getting less intense—an indication of a major change in welding.

The computer-modeling methods used to estimate how strong a structural weld should be are notoriously inexact. So the welds for cars, bridges, and pipelines are overengineered to be safe. Now, after a decade-long

quest, Pingsha Dong has found a way to trim that fat.

Most experts scoffed when Dong, head of welding research at Battelle Memorial Institute in Columbus, Ohio, unveiled the software in 2000—too many such claims had previously flopped. But the technique has won a thumbs-up at Caterpillar and ChevronTexaco, and Ford says it will reduce the cost of producing new car bodies by millions of dollars a year.

MEDICINE CORD BLOOD TO THE RESCUE

A STUDY IN the Nov. 25 issue of *The New England Journal of Medicine* confirms that stem cells in blood extracted from the umbilical cords of newborns can help leukemia patients. Bone marrow from a relative continues to be the preferred source of stem cells, but each year some 16,000 patients in the U.S. fail to find such a match.

A team of researchers led by Dr. Mary J. Laughlin at the Ireland Cancer Center in

Cleveland analyzed the outcomes of 600 leukemia patients who had received cord-blood transplants, bone marrow transplants from a relative, or bone marrow from a closely matched nonrelative. Patients who received bone marrow from relatives fared the best, with 33% of patients surviving the disease. But those who received cord blood did just as well as those who received bone marrow from an unrelated donor—22% of both groups survived. "This study should provide reassurance" to doctors using cord blood, says Laughlin.

—Catherine Arnst

RESEARCH WALKING WITH A SEEING-EYE COMPUTER

SEEING-EYE DOGS and, in some cities, beeping traffic lights help blind people get around town. But even without these aids, the visually impaired may soon be able to cross city streets safely. A research team at Japan's Kyoto Institute of Technology, led by Tadayoshi Shioyama, is developing a system that will use a tiny video camera and an earphone, both mounted on eyeglasses and connected to a handheld computer. When the user approaches an intersection, the computer analyzes the scene, looking for the white stripes of a crosswalk. If it spots them, the person hears directions, such as "10 steps ahead." Next, the crosswalk's length is calculated and vocalized in number-of-steps terms.

Looking toward the traffic light, the computer can identify the color pattern that signals when it is safe to proceed. The project is still in the research stage, but the Nov. 19 issue of *Measurement Science & Technology*, a British journal, says that the distances measured are accurate to within 5%. A prototype could be ready for testing next year.

—Rachel Tiplady



Stealing a Lead In Luxury

Sales of VW's speedy two-door Bentley are leaving high-end rivals in the dust

JAMES BOND didn't just drive Aston Martins before switching to BMWs. As originally written, 007 was a Bentley man. But not since the suave secret agent sped down England's country roads in that 1953 Mark VI in *Moonraker* has the British auto maker been so chic. Bentley's newest model, the revved-up Continental GT, is sold out through 2005. Customers who have snapped one up include Oracle Corp. CEO Lawrence J. Ellison, and actors Denzel Washington, James Caan, and Jennifer Lopez.

In the language of marketing turnabouts, Volkswagen-owned Bentley has done a Gucci. In one short year, the British maker of staid and stately limousines has suddenly become the raciest fashion on wheels. Sales of the \$160,000

Continental GT coupe should top 5,000 cars this year—more than 40% higher than forecasted. “The Continental GT has a sense of exclusivity, like wearing a designer brand,” says Wendy Liebmann, president of WSL Strategic Retail.

By throwing off its pipe-smoke-and-Pimms image, Bentley has stolen the spotlight from its super-luxe rivals, BMW's Rolls Royce and DaimlerChrysler's Maybach. The irony is sweet. Volkswagen outbid BMW in 1998 to buy Rolls and Bentley and their ancient British factory from Vickers PLC for \$917 million, with Rolls viewed as the crown jewel. But an odd twist in the deal allowed the Rolls-Royce aerospace company to sell rights to the Rolls-Royce brand to BMW out from under VW for a mere \$78 million. Meanwhile, DaimlerChrysler opted to compete by reviving a 1930s brand. They all came

to market in 2003. BMW weighed in with its Rolls-Royce Phantom starting \$320,000. DaimlerChrysler revived a version of a prewar luxury nameplate, Maybach, at \$318,000 per copy. Bentley's choice was the most radical, pricing the GT at half the cost of its competitors. Says James N. Hall of auto industry consultancy AutoPacific in Southfield, Mich.: “They took a stratospheric nameplate and made it attainable for people who are wealthy and never considered Bentley.”

BRAGGING RIGHTS

VW REACHED BACK 50 years or more to tap Bentley's pedigree as a consistent winner at Le Mans. The less expensive Continental GT is the fastest four-seater in the world, with a top speed of 198 mph. The coupe's 560-horsepower twin-turbo engine takes the car from zero to 60 mph in a tire-screaming 4.7 seconds. By contrast, the Rolls-Royce, which tops out at 149 mph, looks tame. Attention to such bragging rights, combined with a sleek design, is establishing Bentley as the “driver's car” in the field. “We really positioned the car, and people got the message,” says Bentley Global Marketing Director Adrian Hallmark.

To reach car buyers with seven-figure incomes, Bentley ties into caviar events like boat shows and classic car meets. Bentley also created anticipation for the new GT with one of the longest time lags in recent memory between spy photos of a new car hitting the Internet and cars arriving in showrooms. The company's executives even held intimate dinners with loyal Bentley owners, corporate chieftains, and



From Staid to Sexy

Bentley is so far winning the marketing battle among super-luxury carmakers

BENTLEY CONTINENTAL GT

PRICE \$160,000

2004 SALES (Est.) 5,000 cars

PEDIGREE First of the British luxe cars produced by Volkswagen

PROSPECTS Well-received styling. Great buzz should build demand for future Bentleys. But VW's \$1.9 billion investment means profits are a long way off.

ROLLS-ROYCE PHANTOM

PRICE Starts at \$320,000

2004 SALES (Est.) 750 cars

PEDIGREE First BMW-produced Rolls-Royce

PROSPECTS High-quality German engineering. But the relevancy of the brand is coming into question. Love-it or hate-it design. Sales running 25% below target.

DAIMLERCHRYSLER MAYBACH

PRICE Starts at \$308,000

2004 SALES (Est.) 500-600 cars

PEDIGREE Mercedes reincarnated this long-dormant luxury brand

PROSPECTS Ho-hum regal styling. Superluxury appointments, like tint-at-the-flick-of-a-switch roof panels and reclining rear seats, slow to ignite interest.

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celebrities to whet appetites and stir interest among the fat-wallet brigade. And Bentley pairs up with other luxe brands such as watchmaker Breitling, leaving GTs at the company's retail store in Las Vegas to woo high rollers. "You'll never see Bentley advertising during *Monday Night Football*," says David Coggins, Bentley's U.S. marketing chief.

"THE ODOR OF IRRELEVANCE"

THE GT'S FAST START shows there's a market hungry for over-the-top luxury cars. You wouldn't know that, though, from Rolls-Royce and Maybach in the early going. For the first 10 months of 2004, Bentley sold 4,200 Continental GTs, way beyond the 3,500 it expected for the full year. By contrast, Rolls and Maybach, which at twice the price insist they don't compete against the Bentley, will miss their 2004 targets of 1,000 cars by miles. Rolls may pick up when a convertible is launched, but suffers now from the debatable appeal of a nearly three-ton sedan seemingly designed around the tastes of oil sheikhs and aging dukes. It has also had to rebuild a global sales and supplier network from scratch since VW won those assets in the deal that split Rolls from Bentley. And despite Maybach's unique features, such as glass roof panels that tint at the push of a button, the posh sedan is struggling for attention. "Maybach has the odor of irrelevance, and it's not being talked about the right way," says independent marketing consultant Dennis Keene.

Volkswagen Chairman Bernd Pischetsrieder, who ironically was head of BMW in 1998 when it snatched the Rolls-Royce name from VW, has to make VW's investment—nearly \$2 billion—pay off by raising Bentley sales to 10,000 cars a year, up from 2,000 before the purchase. Given its new cachet, analysts say, Bentley may well hit that number in coming years as new models come to market. Next year it will launch a four-door sedan designed off the GT, and a convertible the year after. The company's older Arnage four-door, which competes head-to-head with Rolls and Maybach in the prestige "big car" segment, is already benefiting from the glow of the GT.

A superluxury brand may need more exclusivity than the Continental GT provides; for that there is said to be a brand-new \$300,000-plus convertible in development. For now, though, Bentley is rebuilding the brand, very nicely, from the bottom up. ■

—By Gail Edmondson with
David Welch in Paris

Economists Are Getting Religion

Can organized faith be explained by supply and demand? They think so

ECONOMICS AND RELIGION have generally been as separate as chalk and cheese. True, Adam Smith delved into religion in the 1776 classic *The Wealth of Nations*. For the most part, though, economists have regarded religion as a dark continent beyond the reach of their analytical tools.

But religion is simply too big for economics to ignore, and now the gulf is closing. A new generation of economists of religion is following in the footsteps of University of Chicago economist Gary S. Becker, who won a Nobel prize for ap-

plying economics to the study of crime, drugs, and family interactions. Economists still avoid such theological questions as the nature of God. But they cast light on the earthly concern of how people "buy" and "sell" the goods and services—material and spiritual—that religious organizations provide. Also, the wake of September 11 and the rise of militant Islam, fresh work by economists on the nature of religiously inspired terrorism is drawing widespread attention including from the CIA and other intelligence agencies.

The sudden interest is vindication for the most tireless advocate for the field



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Laurence R. Iannaccone, 50, an economics professor at George Mason University who studied at Chicago under Becker. He heads a new academic group, the Association for the Study of Religion, Economics & Culture. Academics ignored religion in part out of a belief that it would fade under the onslaught of secularization. Says Iannaccone: "We finally figured out that religion remains a very powerful force in contemporary society."

COMPETING FOR BELIEVERS

THE ECONOMICS of religion is founded on the belief that people are just as rational in their choices about religion as they are about, say, buying a car. "Producers" of religion—churches, synagogues, and mosques—compete for "customers" by seeking converts, drawing members from other congregations, or combating the pull of secular society. Some strains are "cheap" in the sense that they place modest demands on adherents, while others are costly but presumably offer bigger rewards.

The idea that religion involves rational choices extends even to suicide bombers who strike in the name of God. Studies show they are far from depressed loners or brainwashed robots. Instead, says Eli Berman, an associate professor of economics at the University of California at San Diego, suicide bombers typically are motivated young men—and, rarely, women—from average backgrounds. Berman, who has studied Hamas, the Taliban, and like groups, says the bombers share a sense of obligation to what amounts to a "mutual-aid society." Says Berman: "They think of themselves as making great sacrifices for a cause—the way we would think of pilots in the Battle of Britain, or the way the kamikaze thought of themselves."

How should the West fight such terrorism? Berman says one approach would be to promote prosperity through freer markets, which would reduce the supply of potential bombers. Iannaccone gives another answer to the question in a paper called *The Market for Martyrs* that he presented earlier this year to the American Economic Assn. He argues that the supply of would-be terrorists is impossible to suppress. Instead, it makes sense to reduce demand by disrupting the "firms" that sponsor them.

While terrorism is getting lots of attention, economists are also studying how religions affect economic growth. Timur Kuran, a professor of economics and law and the King Faisal Professor of Islamic Thought & Culture at the University of

Southern California, argues that development in Muslim countries has been hindered historically by certain rules of the Koran. For instance, Koranic inheritance law long forbade a father from passing a business on to a favored son but required him to divvy up the legacy among all children (with daughters getting half-portion). That made it harder to set up corporations and stymied economic growth. Another oft-mentioned hurdle is the traditional prohibition on interest payments, but Kuran says there are ways to get around that.

More recently, the Muslim world has accepted the legal conventions of corporate life, with modernizers such as Turkey and Malaysia in the lead. But Kuran, au-

thor of the new book *Islam and Mammon: The Economic Predicaments of Islamism*, says the long-delayed modernization "started from a low base, and it's been trailing ever since."

One sign of the field's coming of age is that it's attracting luminaries from outside the specialty, such as Harvard University's Robert J. Barro, a *BusinessWeek* columnist. Along with his wife and associate, Rachel M. McCleary, Barro found in a paper last year that high levels of religious belief can stimulate economic growth. They concluded that faith may "sustain aspects of individual behavior that enhance productivity," perhaps including honesty and openness to strangers.

Economist Milton Friedman once speculated that free markets and American-style religious pluralism have gone hand in hand, stimulating both economic growth and religion. American religious practices have adapted to economic conditions, says Carmel Chiswick of the University of Illinois at Chicago. "A time has become more expensive, Americans have come to spend less time though often, more money—on religion. Says Chiswick: "When something gets expensive, you try to figure out ways satisfying the same want more cost-effectively."

Just as most economists favor free trade, most economists of religion think laissez-faire approach to religion works best. The U.S., Iannaccone says, was "the world's first free market for religion" and partly for that reason has been largely spared from religious extremism. He harks back to Adam Smith, who wrote that competition among faiths would make religion "free from every mixture of absurdity, imposture, or fanaticism." It may be hard to find God in supply-and-demand curves, but that is stopping economists from bringing their own special insights to religion. ■

—By Joseph Weber
Chicago, with
Peter Coy in New York

The Faith Market

Religion isn't about money, but economists have developed insights by viewing various faiths as "producers" that tailor their products for choosy "consumers"—i.e., adherents. Here is what five economists say about the subject:

LAURENCE R. IANNAACONE, GEORGE MASON UNIVERSITY

The biggest advocate for the economics of religion, he has recently advised military and intelligence officials on how to understand and deter religious terrorism. Wrote an influential paper called *The Market for Martyrs*.



CARMEL U. CHISWICK, UNIVERSITY OF ILLINOIS AT CHICAGO

Looks at how religious practice has changed in the U.S. over the decades as time has become more precious. In some denominations, services have gotten shorter or less frequent.

ROBERT J. BARRO, HARVARD UNIVERSITY

Says religious belief can stimulate economic growth, perhaps because it promotes thrift, hard work, honesty, and openness to strangers. But he finds that all else being equal, heavy participation in religious services can depress growth by consuming people's time.

ELI BERMAN, UNIVERSITY OF CALIFORNIA AT SAN DIEGO

Examines how would-be terrorists prove their loyalty by making "efficient sacrifices" such as serving time in prison or undergoing religious training. Says suicide bombers are psychologically normal.



TIMUR KURAN, UNIVERSITY OF SOUTHERN CALIFORNIA

Links underdevelopment in the Muslim world to Koranic laws, such as inheritance restrictions prohibiting a favored son from inheriting an entire business.

Data: BusinessWeek

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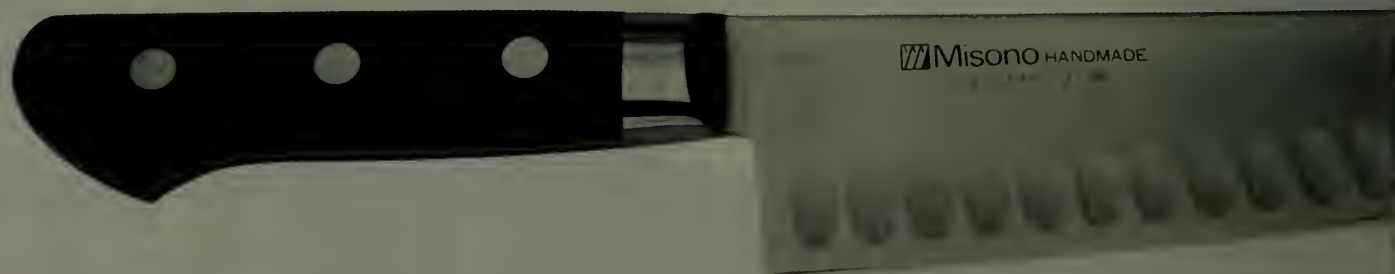
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Chefs' Choices

This year's kitchen-paraphernalia picks will keep the keen cooks on your list on the cutting edge. **BY AMY CORTESE**

Japanese Knife

MARC ORFALY The chef/owner of Pigalle in Boston was thrilled to receive a hand-crafted, stainless-steel knife by Misono, a Japanese company descended from sword makers. The blades are thin and made of high-quality steel for precision, and typically cost \$100 to \$200.



Portable Grill

MICHAEL REIDT, chef at Sevilla, opening in January in Santa Barbara, Calif., lauds the Cadac Safari Chef portable grill for its versatility—for everything from French toast to braised meat. At \$60, it weighs less than 10 lb., and its legs fold for camping or tailgating (dmartstores.com).



Caviar

TODD HUMPHRIES, of Martini House Helena, Calif., loves giving and getting made or gifts, such as spiced pickled wa rind. For those not as handy in the kitche suggests caviar—always sure to



42 Exotic salts from the sea**144** It's time to dump your VCR**150** Books: Broadway, hippies, and horses**156** Barker: Don't bet on Wynn Resorts

AS OUR FAST FOOD NATION gives way to an epicurean culture, Americans are displaying an appetite for everything from aged vinegars to the latest high-tech cooking gadgets. We went to some of the nation's premier foodies—chefs for top restaurants from Brooklyn to Santa Barbara—to find out what kind of food-related gifts have made their hearts beat faster. Many like nothing better than a homemade specialty lovingly prepared by a relative or friend. Even if you can't make it yourself, you can find almost-as-good-as-homemade versions of the items they suggest either online or in gourmet food stores. So, for the food lovers on your list, here are some tasty and trendy gift ideas from the pros:

Cookbook

ANG YOON, chef/owner of Father's Office in Santa Monica, Calif., recommends *The Babbo* cookbook by Mario Batali (\$25.20 at amazon.com).

**Balsamic Vinegar**

MARIO BATALI, the New York chef, TV personality, and cookbook author, uses the Italian pantry as a source of inspiration. There's nothing like special vinegar to elevate a staple. His fave: an aged balsamic.

**Jelly**

SHARON PACHTER AND CHARLES KIELY of The Grocery restaurant in Brooklyn, N.Y., love homemade quince jelly.

**Grater**

CHARLIE PALMER, of Aureole in New York and Dry Creek Kitchen in Sonoma, Calif., picks the conical, 18-inch Todo grater for \$64 from designer Alessi (retromodern.com).

**Pickled Green Tomatoes**

ODY ADAMS, chef and co-owner of Alto in Boston, loves homemade specialties, such as the green tomato pickles her mom jars and gives at holidays.

Bacon

LOUIS OSTEEN, chef/owner of Louis's in Awleys Island, S.C., was thrilled with a Bacon of the Month Club subscription that the Grateful Palette gave him last year.

Zester

ANDREW SUTTON, of Napa Rose in Anaheim, Calif., calls the \$12.95 Microplane zester "the best invention in years." With more surface area than standard zesters, it can finely grate lemon or orange peel (so you get the citrus flavor without the acid) as well as cheese. "It falls like snowflakes," Sutton says. He prefers the longer models without handles (cooking.com).



The Salts Of the Seas

More cooks are discovering the joys of salt from exotic locales. **BY AMY CORTESE**

FEW FOOD CONDIMENTS have as long and storied a history as salt. This ancient staple of civilization was so valued for its ability to preserve food that it was used as currency and inspired cross-cultural trade and even war. Yet, in modern times, salt has become a ho-hum commodity.

That is changing. In the past couple of years, cooks have rediscovered salt, and it is once again a coveted prize. Dozens of exotic varieties are now available—from shimmering Indian Kala Namak to clay-tinged red Hawaiian sea salt. Gourmands are willing to pay as much as \$80 a pound for such rarities, versus about 30¢ a pound for common table salt. What's more, the rainbow-hued grains often come in smart packaging, making them a gift guaranteed to spice up any kitchen.

BRITTANY'S TEMPERATE SHORES

UNLIKE COMMON table salt, which is mined from the land and then refined, the best specialty salts are “harvested” from seawater that's allowed to evaporate in the sun. The process preserves the minerals that lend each salt its distinctive appearance and flavor. Indeed, much like wine, sea salts can evoke the place they are from, whether the temperate shores of Brittany or lava-laden Hawaiian islands.

Salt comes in a variety of sizes and textures, and different salts serve different culinary purposes. The coarser grains impart a dramatic crunch and burst of flavor to a dish, while fine-grained and mildly flavored salts are used for a more subtle effect. Some salts are more like flakes. SaltWorks, a Redmond (Wash.) purveyor (seasalt.com), sells Murray River Pink Flake salt from Australia that looks like peach-colored snowflakes and has a delicate flavor to match.

Most sea salts come with a description of where they're from and how they're harvested. For example, the Il Buco Handcrafted Italian Wooden Sea Salt Box, a trio of Sicilian sea salts, comes with a booklet of handmade paper describing the salts. You'll learn that the Fiore di Sale, or flower of salt, is gathered by Sicilian saltmakers from foam that forms on the Tyrrhenian Sea, and then left to dry in straw baskets under the intense sun.

Perhaps the most versatile sea salt is Fleur De Sel from France. Called the caviar of salts, it has a full flavor and high

mineral content. For something more exotic, try red Alaea Hawaiian salt. Kala Namak, or “black” salt, from India, is actually dusty rose in color and has an unusual sulfurous flavor.

Smoked salts can impart an earthy flavor to dishes. SaltWorks offers a proprietary blend called Fumée de Sel, which is smoked in oak barrels that were previously used to age Chardonnay. Napa Style infuses its salts with herbs such as coriander and garlic.

With so many types to choose from, companies are packaging sea salts together in sampler sets. That might be the best way to introduce someone to the new world of salt. ■



Gourmet Salt



BALAMANDIL FLOR DE SAL
From salt gardens of the Portuguese Algarve
(www.deananddeluca.com)



IL BUCO
Part of a trilogy of salts sold by this restaurant in Manhattan's NoHo district
(ilbuco.com)



SALISH
Pacific sea salt smoked with Northwest red alder wood
(seasalt.com)



VELVET DE GUÉRANDE
French sea salt with consistency of flour and a buttery taste
(seasalt.com)



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Recordable DVDs: Go Ahead. Toss Out Your VCR

They've come way down in price—and your old tapes will take up a fifth of the space they do now once you transfer them to disks. **BY LARRY ARMSTRONG**



GOVIDEO VR2940

\$320-\$360

Includes VCR for tape-to-disk recording; Yes DVD software turns out home-movie disks with bonus music videos

PHILIPS DVDR615

\$270-\$390

Has more video input options than most and has the best editing capabilities for turning out finished-looking DVDs

RCA DRC8300N

\$297-\$350

Built-in VCR allows one-touch dubbing; title library keeps track of about 100 disks and their contents

DON'T YOU THINK IT'S time to retire that VCR? You probably have a DVD player or two, so you already know video cassettes are fast becoming obsolete. And you know that DVD recorders can record TV shows or home movies—with better sound and picture quality than a VCR—on blank disks instead of blank tapes.

So what's holding you back? Too expensive? Too complicated? Over the past month or so, I brought home a half-dozen entry-level models just to prove you wrong. My conclusion? DVD recorders are now priced low enough that even a cheapskate like me should get one. True, if you exploit all of their features, they can be vastly more complex than VCRs, but some brands are friendlier than others.

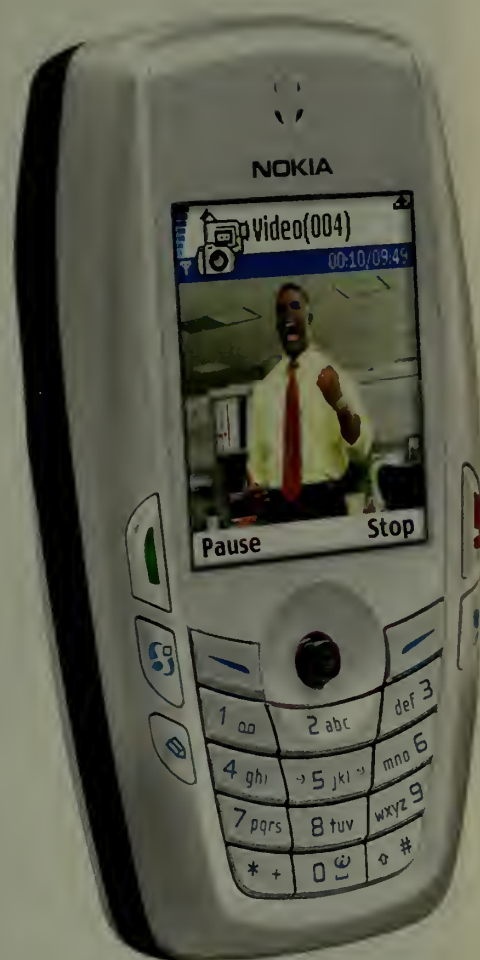
A year ago in this space I predicted that DVD recorders would break the \$300 barrier by the end of this year. They did. Today, Wal-Mart Stores sells one for \$149.67. O.K., that's double the price of a new VCR, but consider the benefits of recording on disks instead of tape. Recordable disks now are as cheap as 30¢ each, less than half the price of a blank tape, and in slim-line cases they take up less than a fifth the storage space. They're more durable, they don't wear out with repeated playing, and you'll never have to worry about one jamming your recorder. You can't accidentally record over another program, and you don't have to toggle between fast-forward and reverse to find the unused part of the tape.

I didn't look at the Wal-Mart special, but I did try a near-clone from Lite-On, a Taiwan-based electronics manufacturer. It records on more types of blank disks than the others, but its built-in TV tuner is mono, not stereo. Mostly, though, I chose new models from brand-name makers, ei



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Shared at 2:35



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Personal Business



PANASONIC DMR-E75V

\$310-\$449

VCR for one-touch dubbing; flexible recording mode insures highest-quality video regardless of program length; has instruction video

LITE-ON LVW-5005

\$220-\$280

Can handle all of the most popular DVD formats and is one of the few machines that also can record video and music on blank CDs

TOSHIBA D-VR3

\$334-\$400

DVD/VCR combo for dubbing; can play S-VHS tapes; has built-in picture-in-picture mode for watching a DVD and TV simultaneously

ther the cheapest model in their line or the next step up. That next step usually is a DVD recorder with a VCR built in: What's nice about that is you don't have to find space for yet another set-top box, and it's the easiest, cord-free way to do what most people want to do—transfer old videos to DVDs before they wear out.

For these prices, roughly \$150 to about \$350, you get a recorder that lets you put in a blank disk, press the record button, and stop when the program is over—pretty much like a VCR. If it comes with a VCR built in, there's a button that lets you copy a tape to DVD or vice versa.

What you don't get are on-screen program guides that let you pick a TV show and record it by clicking on the title. You have to schedule recordings the old-fash-

ioned way, entering the time, date, and channel, or the Guide Plus code printed in newspaper TV listings. None of these recorders can change the channel on your cable- or satellite-TV box, so you have to make sure it's on the right channel before recording starts. That's not a problem if you're using an antenna or if your cable service doesn't require a set-top box.

My recommendations? Figure out how you use your VCR before you buy a DVD recorder. If you have a hard time programming your VCR, steer clear of the Panasonic and Philips models. Of the recorders I looked at, they were the most difficult to figure out, with complicated on-screen menus, incomprehensible instruction manuals, and, in Philips' case, a remote control with button labels de-

signed to baffle you (what's the difference between "O.K." and "Select"?).

If you have a digital camcorder, be sure to pick a recorder that has a digital video input, called FireWire or i.Link, so that you can copy home movies directly from the camcorder to DVD. The Panasonic and RCA models I tested don't. If your home movies are on videocassettes or you have a library of VHS tapes that you want to preserve on disks, you'll find it easier to do if you get a recorder with built-in VCR.

FUN WITH EDITING

YOUR BEST BETS AMONG the entry-level recorders are the Panasonic and Toshiba models if you mostly record shows to watch later and then delete them. Both can record on DVD-RAM disks, which can be erased and rewritten 100,000 times. And you can record and play them at the same time: You can watch a program you've already recorded while it's recording another, or you can start watching the beginning of a show while it's still recording it.

If you're willing to pay more, get a DVD recorder with a built-in hard-disk drive so you can record and watch programs without burning them onto a DVD. Hard disks also make it easier to edit programs before you commit them to DVD, deleting the commercials in a TV show, say, or those scenes in home movies where the camcorder was taking pictures of the sidewalk. My current favorite among the more expensive models is Toshiba's RD-XS32, which you should be able to find for about \$400.

Shop carefully. Since you can't try these out in a store, it's a good idea to narrow your search to a few models and download the instruction manuals from the manufacturers' Web sites. Don't get hung up on the differences between those that use +R or -R disks—just buy the disk the recorder needs. And ask about the return policy: Some retailers, especially online stores, charge a 15% "restocking fee" if you're not happy with your purchase. And compare prices. I found that they can vary by as much as \$100 or more depending on the retailer.

Then just sit back, dim the lights, and start fiddling with your new electronic toy. Record a few programs, transfer a few tapes, and if you're like me, you'll be ready to junk that old VCR sooner than you think. ■

BusinessWeek online For reviews of handheld video players, go to www.businessweek.com/magazine/extra.htm



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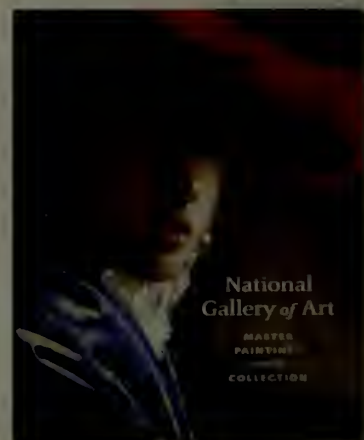
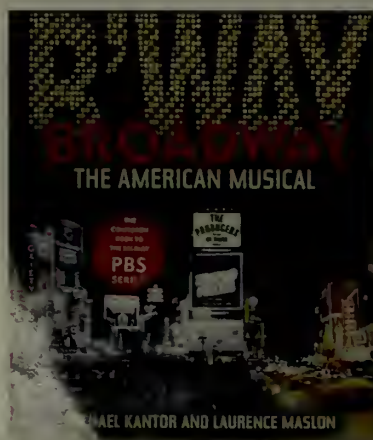
Laughs, Music, Art, and Horses

Coffee-table tomes for everyone on your list. **BY THANE PETERSON**

IN A DEPARTMENT STORE hung with holiday garlands, a man in an overcoat anxiously leans toward a young woman sitting behind a desk marked "Gift Counselor" and asks: "What do you recommend for someone who wants a mink coat?" If you're facing gift-giving quandaries of your own, the book that contains this 1950 cartoon is among the new crop of coffee-table tomes you might want to give someone on your holiday list. **The Complete Cartoons of The New Yorker** (Black Dog & Leventhal Publishers, \$60) reproduces every witty illustration published in the magazine since its launch in 1925—2,500 of them in the book's 656 pages and all 68,647 more on two computer disks tucked inside the front cover. It's a compelling social history, with legendary cartoonists such as James Thurber and Peter Arno poking fun at everything from war and the stock market to the evolution of male-female relations. Another fun gift book with multimedia elements is **The Sinatra Treasures: Intimate Photos, Mementos, and Music from the Sinatra Family Collection** (Bulfinch Press, \$45). It in-



The Great LIFE Photographers The magazine's Andreas Feininger took this beautifully composed shot of photographer Dennis Stock in 1951. It's one of several hundred memorable works from such renowned photojournalists as Margaret Bourke-White, Larry Burrows, Alfred Eisenstaedt, and Gordon Parks.



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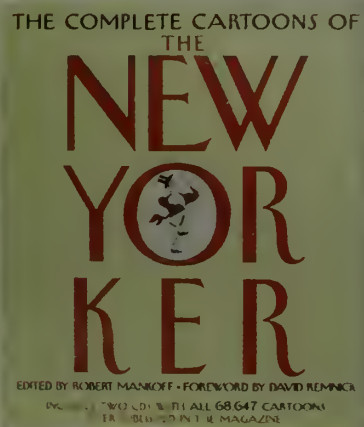
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cludes an audio CD of interviews and hard-to-find recordings (including a take-off of *High Hopes* Sinatra recorded as a John F. Kennedy campaign song in 1960), as well as memorabilia tucked into little envelopes, such as a reproduction of the sheet music Ol' Blue Eyes used the first time he recorded *My Way* in 1968. For an aspiring musician, try **Totally Guitar: The Definitive Guide** (Thunder Bay Press, \$29.98). It gives the lowdown on guitar manufacturers and their products, offers tips on tuning and maintaining the instrument, and describes how to play various styles, from blues to classical.



There are other worthwhile books with pop culture themes. **Broadway: The American Musical** (Bulfinch, \$60) is full of lore, photos, and posters from famous musical productions. For the person who gets a kick out of movies such as *Shrek 2* and *Finding Nemo*, consider **Animation Now!** (Taschen, \$39.99), a survey of 80 of the greatest cartoonists and animation studios worldwide, from Hollywood's Pixar, Walt



Disney, and DreamWorks SKG, to decidedly higher-brow practitioners such as South African artist William Kentridge. A DVD included with the book provides samples of the work as well as commercials and trailers made by the artists. **Hippie** (Sterling Publishing, \$24.95) illuminates the youth culture of drugs and rock 'n' roll that flowered from 1965 to 1972. To some more conservative observers, perusing photos of novelist Ken Kesey atop his psychedelic "Merry Pranksters" schoolbus and a naked woman joyously dancing among clothed attendees at a rock music festival may be like examining evidence of an alien civilization of the carefree.

LITTLE-KNOWN GENIUSES

A GOOD CHOICE for a business associate is **They Made America** (Little, Brown, \$40), a collection of vivid profiles of America's greatest inventors and innovators. Author Harold Evans' gift for anecdote breathes new dimension into the oft-told stories of such giants as Thomas Edison and Cyrus McCormick. Evans has a provocative take on who was really important: He glosses over Alexander Graham Bell for being insufficiently innovative while giving star treatment to little-known figures such as Samuel Insull (he pioneered cheap electricity)

and Gary Kildall (he wrote the first floppy-disk operating system).

The Architecture and Design of Man and Woman (Doubleday, \$50) is a fascinating look inside the human body. It uses computer modeling coupled with images from powerful

The New Yorker book's two CD feature 68,647 cartoon

microscopes and body scans to illustrate how hearing, touch, and other bodily systems work. For example, a skeleton pirouettes and does a handstand to show how the body distributes force.

A marvelous new photo collection **Magnum Stories** (Phaidon Press, \$79.95) which profiles photographers from the legendary agency founded by Henri Cartier-Bresson (who died recently) to Robert Capa. The images range from blurry shots taken by Capa from the war to Raymond Depardon's affectionate study of his family's farm in France. **Great LIFE Photographers** (Bulfinch, \$39.95) follows a similar format for photographers who worked for *Life* magazine. Images such as one of the Beatles cavorting in a swimming pool are instantly recognizable, but less well-known photos, such as a 1952 shot of a roller-skating hore are equally charming.

Two of the world's greatest art museums get loving treatment in **Paintings at the Musée d'Orsay** (Abrams, \$75) and **National Gallery of Art: Master Paintings from the Collection** (Abrams, \$60). The first focuses on the great Impressionist era paintings at Paris' Musée d'Orsay including such iconic works as Edouard Manet's *Olympia* and Paul Cezanne's *The Card Players*. The second shows the exquisite collection of the National Gallery of Art in Washington, which includes several magnificent Vermeers and Goyas as well as seminal modern works such as Picasso's 1905 *Family of Saltimbanques*.

A good gift for the horse-obsessed is **People We Know, Horses They Love** (Roda, \$39.95). It documents in words and photographs the passion many celebrities have for horses and riding. Comedian Chevy Chase, for instance, says he can't live without his love of horses though his grandfather, a renowned equestrian portraitist, The 6-ft., 4-in. Chase rides a stub Icelandic breed of horse that barely keeps his feet off the ground. Now is that fodder for a cartoon or what? ■

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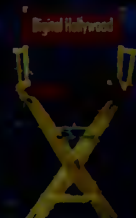
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Tastings at Home

A wine club for the grape lover. **BY JANE BLACK**

IF YOU'RE SHOPPING FOR SOMETHING to give an oenophile, a wine club membership is a gift that keeps on giving. Such clubs used to have a reputation for poor-quality wines. But as people's tastes have become more refined, clubs have been launched to expose aficionados to pricier wines they might not otherwise buy.

Clubs usually make monthly deliveries that include the wine, tasting notes, profiles of the wineries, and discounts on reorders. There are three types:

INTERNATIONAL These clubs offer the broadest selection. For example, the new Kimpton Life Wine Society (www.kimptonlife.com/kl_wine.html) ships hard-to-find wines. Membership runs \$50, \$100,

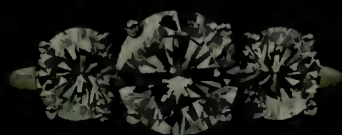
or \$175 for two bottles a month. At the low end, Wine Odyssey, Wine.com's most popular club for beginners, is priced at \$19.95 a month for two bottles.

REGIONAL These are best for enthusiasts who want to deepen their knowledge of a particular region. An Italian Wine Merchants membership, which includes six Spiegelau wine glasses and a 515-page book on Italian wines, ranges from \$97 to \$259 a month for three bottles (italianwinermerchant.com). The California Wine Club (cawineclub.com) offers exposure to California's boutique wineries for as little as \$32.95 a month for two bottles.

PROPRIETARY Most of the blue-chip California vineyards have their own clubs, which ship limited-production

wines that are not nationally distributed. Ridge Vineyard's Advanced Tasting Program, for example, serves up new single-vineyard reds such as syrah and zinfandel blends starting at about \$65 for a two-bottle shipment (www.ridgevine.com/clubs).

One caveat: Some states prohibit wine shipments directly to consumers. But there are loopholes, so check with individual clubs on restrictions. ■



THIS CHRISTMAS, TRY A
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A DIAMOND IS FOREVER

EDITED BY TODDI GUTNER

BANKING

WHEN YOU NEED TO SEND CASH IN A FLASH

WHAT PARENT OF a college-age child hasn't gotten the frantic call: "Send money quick!"? Some big banks are rolling out services for just that type of call for cash. **Wells Fargo** and **Bank of America** customers can now transfer funds via the Net to family and friends for free. **Citibank** charges \$5 for a similar service it launched last year.

With the click of a mouse, cash moves from one checking or

savings account to another and is available for ATM withdrawal the same day.

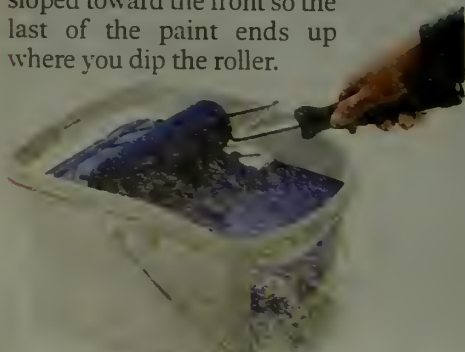
Before this, the best quick-cash option was a wire transfer, which cost up to \$30. For now, senders and receivers must have accounts at the same bank, though **Bank of America** and **Wells** plan to offer interbank transfers next year.

—Justin Hibbard

GADGETS

PAINTING MADE EASY

NO NEED TO POUR paint from cans with **Dutch Boy's** new container. **Ready to Roll** comes with 2.5 gallons of interior paint or primer, enough to finish a typical project. It has a zip-off top that's easy to open and close, and the built-in roller tray makes for easy cleanup. The bottom is even sloped toward the front so the last of the paint ends up where you dip the roller.



GIFTS

Plastic Scrooge?

GIFT CARDS CAN MAKE THE holiday shopping season a lot less stressful. They're easy for givers to buy, and easy for recipients to use. But many cards come with Scrooge-like fees and restrictions.

First, there are big differences between bank-affiliated and store-branded cards. **Prepaid Visa, MasterCard, Discover, and American Express** cards issued by banks often come loaded with fees, including charges that eat away at a card's value if it isn't redeemed in a year or two. You have to pay for bank cards: \$5.95 to buy a \$100 **Bank of America Visa** gift card, for example. And if you use them to get cash from an ATM, you'll pay as much as \$2.50 per transaction. Retailers' cards are redeemable only in the stores that issue them. However, most store-branded cards bought in person sell without an up-front fee, and expiration dates are becoming less common.

One tip: Treat all cards as cash, and always write down the ID number. That will make it a lot easier to get a replacement if the card is lost or stolen. —Suzanne Woolf

TIME OFF

IF YOU'RE NOT SLEEPY and there is no place you're going to, head over to Seattle's **Experience Music Project** (emplive.com) to see the tambourine that inspired **Bob Dylan's Mr. Tambourine Man**. It's part of the rock museum's latest exhibit, "Bob Dylan's American Journey, 1956-1966," which runs through Sept. 5, 2005. The exhibit includes such artifacts as a letter Dylan wrote to the mother of his then-girlfriend, Joan Baez, in which he pretended to be Baez.

—Jay Greene



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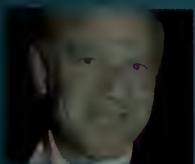
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Co-founder, Dreamworks SKG
Thu, Feb 17, 8 pm



Carly Fiorina

Chairman and Chief Executive Officer, Hewlett-Packard
Thu, Mar 3, 8 pm



Barry Diller

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BY ROBERT BARKER

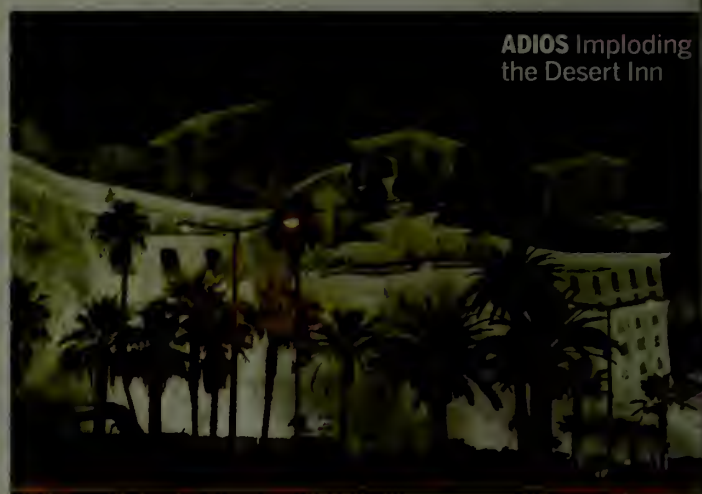
Wynn Resorts: Snake Eyes for Investors?

Set in Las Vegas, the hit show *CSI: Crime Scene Investigation* hooked viewers by setting loose a band of cool empiricists at fantasy's hot epicenter. One moment, a lady steps out of her red, backless dress; the next, an investigator checks a corpse's liver temperature. The contrast might help investors understand Vegas'

hottest stock: Wynn Resorts, the vehicle that serial casino impresario Steve Wynn is using to finance the development of his two latest properties. Wynn Macau, a 600-room resort on the Chinese island near Hong Kong, isn't due to open before 2006. Yet by next April, Wynn Las Vegas is set to host its first guests. Already, Wynn has plans to expand it. On Nov. 16 the company imploded what was left of the old Desert Inn to make way for what it's calling Encore at Wynn Las Vegas. As the Desert Inn fell, Wynn Resorts shares hovered above \$57—more than double where they were at the dawn of 2004.

INVESTORS MAY BE PARTYING in fantasyland, though. To see what I mean, put on a *CSI* forensics jumpsuit (good for protecting cocktail attire from blood and tissue samples) and coolly examine the clues. First you might look for profits at Wynn Resorts. You'd find no evidence of them—in fact, there are no revenues to speak of. Since its inception, Wynn Resorts has spilled \$181 million in red ink while developing its properties. Next, check cash flow: Mostly by sales of stock (\$808 million worth) and bonds (\$1.2 billion), Wynn Resorts had raised \$2.2 billion through September. Operations, buying real estate, and construction costs used up more than \$2 billion. On Nov. 15, Wynn Resorts raised a fresh \$453 million by selling 7.5 million more new common shares.

That brought the total number of shares Wynn has issued, or is on the hook to issue via options, restricted stock, and



ADIOS Imploding the Desert Inn

convertible debentures, nearly to 110 million. At \$57 a share, that gives Wynn Resorts an equity value of \$6.3 billion. Investigators might ask: What other companies have equity values over \$6 billion but revenues under, to be generous, \$100 million? A check of the *Value Line Investment Survey* data base, with 7,824 companies, finds just one other with a market value of more than \$6 billion on \$100 million or less in revenue: Sirius Satellite Radio. No other public companies with that little in revenue have market caps of even \$3 billion.

One day—perhaps next year, after Wynn Las Vegas opens—operations will produce cash. How much cash flow would justify its valuation? Including debt, Wynn's enterprise value is about \$7 billion. That's what a takeover would cost. You can get a clue about the hopes held in that figure by comparing Wynn to two rivals that this year agreed to buyouts. Caesars Entertainment accepted an offer of \$9.4 billion from Harrah's Entertainment; Mandalay Resort Group is taking a bid of \$8.1 billion from MGM Mirage. Wynn's valuation is in the same league, though Caesars and Mandalay today operate far more hotel rooms and much more casino space than Wynn has dared envision. For years to come they figure to generate many times more cash flow (table).

No survey of Wynn's stock market value would be complete without a glance at Steve Wynn's record at Mirage Resorts. Its shareholders saw average annual gains of 25%. Investors buying into Wynn Resorts must be hoping for an encore. Discarding their latex gloves, the *CSI* crew would conclude that this bet isn't likely to pay out any more than it already has. ■

E-mail: rb@businessweek.com

Wynn in Fantasyland

COMPANY (SYMBOL)	ENTERPRISE VALUE	2005 EBITDA*	HOTEL ROOMS	CASINO SPACE (SQUARE FEET)
Caesars Entertainment (CZR)	\$9,400	\$1.146	26,000	2,000,000
Mandalay Resort Group (MBG)	8,100	807	25,902	946,325
Wynn Resorts (WYNN)	701 [†]	192	4,816	**

Data: Company reports. Reuters estimate

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BY GENE G. MARCIAL

PRIME REAL ESTATE MAKES **SAKS** A STOCK BARGAIN, SOME SAY.

BOSTON SCIENTIFIC LOOKS SICKLY—BUT NOT TERMINALLY ILL.

FDA APPROVAL IS EXPECTED FOR A **BIOENVISION** LEUKEMIA DRUG

A Beautiful Buy at Saks?

THE KMART-SEARS DEAL has reignited interest in retail: One stock that several pros are high on—but that the Street doesn't care about—is Saks (SKS), operator of some 350 luxury and traditional department stores. The stock has been hammered since April, when it nearly hit 18; it's now at 13.39. Deutsche Bank tags it a "sell," Morgan Stanley "underweight," and Merrill Lynch and others "neutral." Disappointing sales and earnings have prompted analysts to lower estimates. But Mark Boyar of Boyar Asset Management, which owns shares, is upbeat: "Saks is an example of undervalued real estate," he says. Saks owns an unusually high portion of its stores—40% of gross square footage—including its flagship Saks Fifth Avenue. He "conservatively" values Saks-owned properties at \$3.3 billion, or \$23.50 a share net of debt. But even without the real estate, Saks is attractive, he says. It sells 20% below book value and close to its 52-week low of 11.61, down from a high of 44.43 in 1999. Still, Saks "hasn't lived up to its potential," says Boyar. He now sees it as a turnaround. But if Saks stock continues to weaken, it will attract a suitor more interested in real estate than retailing, he says. Todd Slater of Lazard, who also likes Saks, expects it to earn 67¢ a share in fiscal 2005 ending Jan. 30 and 99¢ in 2006, vs. 58¢ in 2004.

HAMMERED DOWN

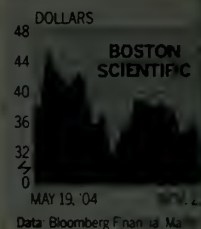


Boston Scientific: Anemic—for Now

BOSTON SCIENTIFIC (BSX) is far from robust—since its summer recall of 100,000 coronary stents and since its lowered fourth-quarter profit forecast. Analysts quickly cut estimates, driving shares down from 46 in May to 33.36 on Nov. 23. But John Maloney of M&R Capital Management, which owns stock, says that BSX—a maker of surgical devices for cardiology, oncology, and urology—is too undervalued to ignore. With its leadership in stents (70% of the market vs. 30% for Johnson & Johnson) and its "rich pipeline" of other products, BSX shouldn't be trading so low, he argues. "It is the cheapest in the medical-device group," he says, selling at only 15 times his 2005 profit estimate of \$2.25 a share, and 13.6 times his \$2.50 for 2006. His 12-to-18-month target: 50—or 20

times his 2006 estimate. BSX may lose market share in stents, he says, as competition heats up, but it will remain No. 1. Non-stent products, such as tools for cardiac surgery, will offset any loss. Maloney sees sales of \$5.5 billion in 2004, \$6.2 billion in 2005, \$7 billion in 2006, and \$8 billion in 2007. Michael Weinstein of J.P. Morgan Securities, who rates BSX "outperform," is confident of its "long-term prospects—driven by a solid product pipeline."

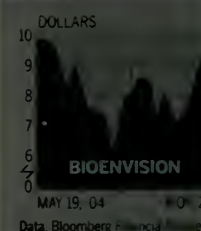
TIRED BLOOD



Why There's New Life At Bioenvision

BIOENVISION (BIVN) has been popping, from 6 a share August to 9.35 on Nov. 23. Its leading product, Clofarabine, for treating leukemia in children, may get Food & Drug Administration approval soon. Cory Kasimov of Oppenheimer, who rates the stock a buy, says three events may give it a boost: The FDA's oncology advisory panel is expected to review Clofarabine on Dec. 1—and he's convinced it will recommend an O.K. If so, it could get FDA approval by Dec. 30. That could push European approval by mid-2005. Developed with ILEX Oncology (being acquired by Genzyme), Clofarabine could be "the first drug to be initially labeled for pediatric oncology in over a decade," says Kasimov. The drug has a market yearly potential of \$400 million, says David Luci, CFO and general counsel. He believes it could also get approved for adult leukemia, a bigger market. Oppenheimer's Kasimov sees Bioenvision making a profit in 2006. When last mentioned in this column, on Mar. 22, it traded at 6.40. Kasimov has a 12-month target of 16. On Nov. 19, Bioenvision adopted a poison pill to thwart a rumored takeover bid by suitors, including Bristol-Myers Squibb and Genzyme. The top shareholder is billionaire George Soros, with a 27% stake. ■

ON THE UP AND UP



BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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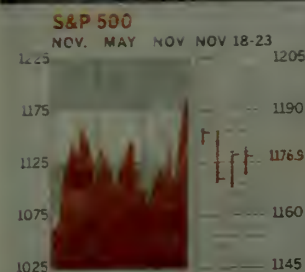
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Personal Business Figures of the Week

STOCKS



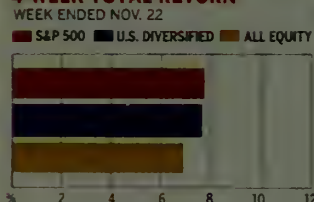
COMMENTARY

The Dow and NASDAQ were headed to new highs, when Fed Chairman Greenspan's remarks on the dollar on Nov. 19 sent stocks into a funk. Oil, bubbling up again, undercut optimism, too. Investors spent the next sessions digging out of the hole. The tech-laden NASDAQ got a helping hand from Apple Computer, rising sharply after an analyst set a \$100 price target.

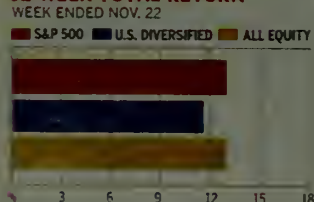
Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN



52-WEEK TOTAL RETURN



Data: Standard & Poor's

U.S. MARKETS

	NOV. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1176.9	-0.4	5.8	13.7
Dow Jones Industrials	10,492.6	-0.5	0.4	9.0
NASDAQ Composite	2084.3	-0.7	4.0	10.1
S&P MidCap 400	634.5	-0.1	10.2	15.7
S&P SmallCap 600	317.7	0.5	17.5	23.6
DJ Wilshire 5000	11,549.9	-0.3	6.9	14.4

SECTORS

	NOV. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	688.3	0.4	10.6	16.1
BW Info Tech 100**	357.6	-1.3	2.0	9.3
S&P/BARRA Growth	565.6	-1.1	1.7	8.0
S&P/BARRA Value	607.0	0.3	10.0	19.5
S&P Energy	292.7	3.5	30.6	51.6
S&P Financials	396.1	-0.7	4.3	11.3
S&P REIT	137.4	0.4	18.6	24.2
S&P Transportation	233.9	0.5	15.8	20.7
S&P Utilities	140.9	1.7	19.0	29.7
GSTI Internet	158.8	-1.6	9.8	19.5
PSE Technology	747.8	-0.6	7.2	14.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Steel	27.9	Internet Retail	110.9
Agricultural Products	25.0	Steel	94.2
Health-Care Distributors	24.6	Internet Software	84.1
Managed Health Care	24.6	Wireless Services	77.2
Tires & Rubber	21.1	Oil & Gas Refining	77.0

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Technology	8.9	Natural Resources	48.8
Communications	8.2	Latin America	39.0
Small-cap Value	8.1	Utilities	28.9
Latin America	8.1	Real Estate	28.6
LAGGARDS		LAGGARDS	
Domestic Hybrid	4.2	Technology	1.0
Real Estate	4.3	Precious Metals	7.0
Precious Metals	4.8	Small-cap Growth	7.4
Miscellaneous	4.8	Large-cap Growth	7.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Fidelity Sel. Mdc. Del.	20.4	ProFunds Energy Utr. Inv.	82.5
ProFunds UltraOTC Inv.	19.6	ProFds. Wriss. Utrsr. Inv.	81.5
Rydex Dyn. Veloc. 100 H	19.4	iShares MSCI Austria Idx.	70.6
ProFds. Ult. Sm. Cap Inv.	18.2	State St. Rsch. Gl. Rs. A	70.5
LAGGARDS		LAGGARDS	
GE Contra	-85.5	GE Contra	-99.9
ProFunds UltSh. OTC Inv	-17.0	ProFds. Smicdr. Utrsr. Inv.	-37.6
Rydex Dyn. Vent. 100 H	-17.0	Thurlo Growth	-37.1
ProFds. USH. Sm. Cap Inv.	-15.8	GMO Emerg. Mkts. Qty. III	-35.8

GLOBAL MARKETS

	NOV. 23	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1307.9*	-1.3	10.9	23
London (FT-SE 100)	4742.4	-1.1	5.9	9
Paris (CAC 40)	3780.1	-1.7	6.2	12
Frankfurt (DAX)	4113.4	3.7	3.7	12
Tokyo (NIKKEI 225)	10,849.4	-5.8	-1.8	6
Hong Kong (Hang Seng)	14,023.3	1.4	11.5	18
Toronto (S&P/TSX Composite)	8995.2	0.1	9.4	15
Mexico City (IPC)	11,876.6	-1.2	35.0	42

FUNDAMENTALS

	NOV. 22	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.95%	1.96%	1.63%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.9	19.9	26.6
S&P 500 P/E Ratio (Next 12 mos.)*	16.5	16.6	17.7
First Call Earnings Revision*	-0.21%	-0.51%	-0.72%

TECHNICAL INDICATORS

	NOV. 22	WEEK AGO	READING
S&P 500 200-day average	1121.6	1120.7	Positive
Stocks above 200-day average	74.3%	72.0%	Negative
Options: Put/call ratio	0.62	0.62	Neutral
Insiders: Vickers NYSE Sell/buy ratio	5.50	4.97	Negative

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Office Svcs. & Supplies	-0.1	IT Consulting	-28
Instrumentation	0.2	Insurance Brokers	-28
Brewers	0.6	Semiconductor Equip.	-25
Pharmaceuticals	0.8	Semiconductors	-21
Household Products	1.2	Airlines	-13

INTEREST RATES

KEY RATES

	NOV. 23	WEEK AGO	YEAR AGO
Money Market Funds	1.46%	1.42%	0.62%
90-Day Treasury Bills	2.17	2.12	0.93
2-Year Treasury Notes	2.95	2.83	1.84
10-Year Treasury Notes	4.19	4.14	4.18
30-Year Treasury Bonds	4.84	4.84	5.03
30-Year Fixed Mortgage †	5.73	5.73	5.69

†BankQuote Inc

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR BOND	30-YR BOND
General Obligations	3.51	4.04
Taxable Equivalent	5.10	6.47
Insured Revenue Bonds	3.76	4.02
Taxable Equivalent	5.37	6.64

THE WEEK AHEAD

GROSS DOMESTIC PRODUCT

(REVISED) Tuesday, Nov. 30, 8:30 a.m. EST » The economy probably grew at an annual rate of 3.8% in the third quarter, up slightly from the initial estimate of 3.7%. That's based on the median forecast of economists surveyed by Action Economics LLC.

CONSUMER CONFIDENCE

Tuesday, Nov. 30 10 a.m. EST » The Conference Board's November confidence index

probably rebounded to 95.5, after dropping to 92.8 in October.

PURCHASING MANAGERS' INDEX

Wednesday, Dec. 1, 10 a.m. EST » November's factory activity index from the Institute for Supply Management most likely eased to 56.5%, from 56.8% in October.

BEIGE BOOK

Wednesday, Dec. 1, 2 p.m. EST » The Federal Reserve will release its report on regional economic activity ahead of the Dec. 14 monetary policy

meeting. The consensus estimate from Action Economics is for another hike in interest rates, to 2.25%, from 2%.

EMPLOYMENT

Friday, Dec. 3, 8:30 a.m. EST » November nonfarm payrolls are expected to have risen by 195,000, after a 337,000 jump in October. Factory payrolls probably added 5,000 jobs, reversing a fall of 5,000. The November jobless rate most likely slipped back to 5.4%, from 5.5%.

The BusinessWeek production index rose to 231.1 for the week ended Nov. 13, and grew 11.5% from a year ago. Before calculation of the four-week moving average, the index slipped to 231.1.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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How America Can Meet 'The China Price'

IMAGINE TILTING America on its side, with millions of manufacturing jobs pouring out across the Pacific, to China. Now make the picture even scarier. Tilt America so that thousands of service jobs flow out as well, to India. We're not just talking about low-end toy-making or call-center jobs but well-paying precision-tool-making and high-end engineering and software work. With the dollar falling relentlessly and with the current account deficit up to a record 6% of America's gross domestic product, the U.S. is experiencing a shock and awe of its own as global economic power shifts to Asia (page 102).

So unprecedented, so colossal, and so fast is this change that eminent economists such as Paul A. Samuelson are beginning to question the basic tenets of free-trade theory. Is it possible that David Ricardo's economic analysis doesn't work for the 21st century? Can the theory of comparative advantage operate when China and India compete not only with low-cost labor but also with highly educated, highly skilled workers who have access to broadband and the Internet? What is the U.S. supposed to specialize in when Asia competes across the board in manufacturing and services in both low-end and high-tech jobs? Is the future prosperity of America in jeopardy?

We don't think so. It's all too easy to fall into a spiral of despair when thinking of Asia. Certainly importing goods, outsourcing production, and offshoring services represent major economic challenges. Yet even though many industries and companies are suffering dislocation and their employees are feeling pain, the U.S. economy as a whole should do very well in the future. But there are a lot of "ifs" behind that proposition. The U.S. should be in fine shape if it remains flexible, entrepreneurial, and cutting-edge smart, and if Washington acts to bring the nation's federal budget deficit under control.

The truth is that there are huge benefits accruing to the U.S. from China. Unlike Japan, China is an extremely open market, and American multinational companies are making big profits selling products there. By outsourcing production, corporations are lowering costs for U.S. consumers, keeping inflation low. Doing business in China raises U.S. corporate

returns on capital—and boosts share prices. Anyone with a pension, a 401(k) retirement account, or an equity mutual fund stands to benefit.

But the great fear among economists is that if too many high-tech manufacturing and sophisticated service jobs shift to China and India at the same time, wages will fall in large segments of the American economy. Whole sectors could be hit hard. Then the benefits of the China trade would accrue to corporations and investors only, not to the workers or consumers. In the end, falling incomes could slow overall economic growth.

What to do? Leveling the playing field can help. China's currency is undervalued by as much as 30%—roughly equal to the low "China price" that attracts companies to its shores. Washington should pressure Beijing to revalue or at least widen the band in which the yuan is pegged to the dollar. So, too, should Washington insist on China's enforcing intellectual-property laws. Some 92% of Chinese computers run on software that is pirated or unlicensed. This worsens

the trade deficit and helps Chinese companies underbid U.S. rivals.

But the most important thing is for America to get its own competitive house in order. While Washington pours billions into farm subsidies and pork barrel spending, it is cutting back on federal Pell Grants for college kids. The U.S. needs far more engineering, math, and science graduates. Retraining workers

Start by cutting the budget deficit. And boost funds for education

and easing the pain of moving to new jobs are also important. To help, Congress should act on plans for tax-advantaged savings accounts and wage insurance. Most important, Congress should curb the budget deficit. With domestic savings low, some \$4 trillion to \$6 trillion of deficit over the next 10 years will have to be financed from overseas money. That means even higher current account deficits—which are probably not sustainable. Without a sharp cut in the budget deficit, either interest rates will rise substantially or the dollar is likely to crash.

The integration of the U.S. and Chinese economies has improved growth, incomes, and profits in both countries to date. Indeed, the world as a whole has gained. But managing a new Sino-American economy will require compromise, finesse, and tough policy choices. For the benefits to continue to outweigh the losses, those choices must be made.



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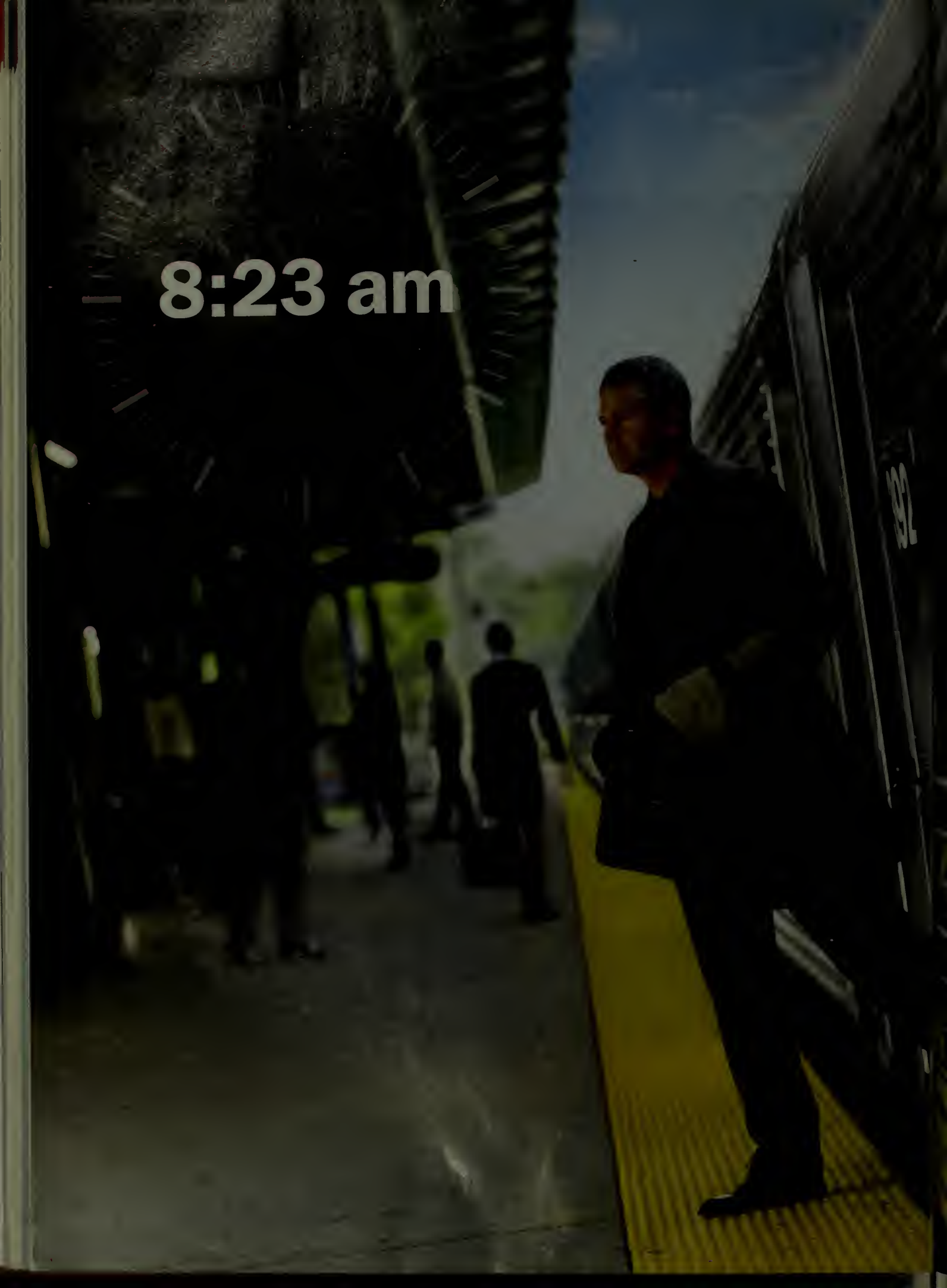
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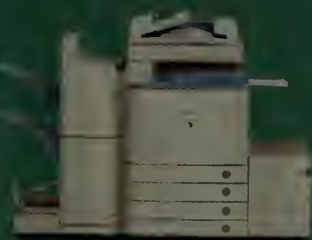
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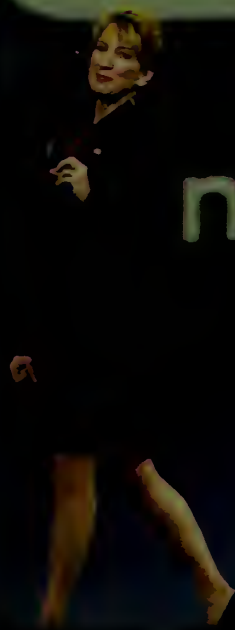
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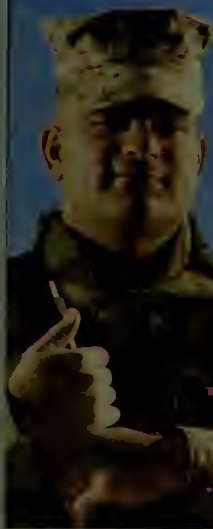
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Special Report: The Changing Face of Skin Care

The rise of "cosmeceuticals" blurs the lines between dermatology and cosmetology in ways that many consumers don't understand. Here's what you should know. Plus: A product slide show



Will 3G Answer Vodafone's Call?

Badly in need of a financial boost, the British mobile-phone giant is counting on a high-profile launch of advanced third-generation services to keep it ahead of the many rivals charging into the field

A Sirius Move for the Zen Master of Radio

As new CEO at the satellite-radio company, Infinity Broadcasting architect and Viacom vet Mel Karmazin sees plenty of potential. And his old pal Howard Stern will play a big role



Funding and Family: Mix with Care

Experts estimate that 85% to 90% of all seed money for small businesses comes from friends and family, but asking for startup cash can be tricky. Here are tips on how to appeal to those closest to you for money

Big Blue's Solid Stake in Desktop Computing



IBM's Workplace package is catching on with clients, and more software makers are signing up. Still, it won't be smashing Windows anytime soon

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THE ARCHITECTS OF TIME

JP Front

"When they showed the category, I thought, 'Oh, this is trouble.' Business and industry—not really my thing."

—Ken Jennings, who won \$2,520,700 playing Jeopardy! before losing on a question about H&R Block

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WEB WATCH

THE BEAST IN CISCO'S REARVIEW

ALL CISCO SYSTEMS, king of computer networking, get Linuxed? If a group of open-source software enthusiasts have their way, it could happen. Atanu Ghosh, a prominent researcher at the

microprocessors from the likes of **Intel**—the same way Linux has become a cheap answer for PC and server operating systems.

The project is called the eXtensible Open Router Platform—XORP, in tech-speak. If it's a success, XORP could become a low-cost alternative to expensive networking gear from Cisco and others.

Ghosh has a basic version of XORP and has begun work on a more sophisticated update. He has raised \$3 million from backers such as Intel, **Microsoft**, and the **National Science Foundation**.

Of course, XORP is no overnight threat to Cisco. But executives

at the \$22 billion company should keep an eye out. In tech, someone always finds a way to turn today's big-ticket items into tomorrow's commodities. Cisco declined comment. —Alex Salkever



International Computer Science Institute in Berkeley, Calif., is leading an ambitious project to provide free software that will route data through computer networks using inexpensive hardware and

A LOGO THAT KICKS Beckham's Adidas deal is worth \$100 million



FASHION FRONT

Brand It Like Beckham

IN THE U.S., most people still don't know the world's most popular athlete, David Beckham. But the British footballer and his key sponsor, **adidas-Solomon**, hope to change that with a new line of soccer and casual wear that will bear a Beckham logo based on his famous free kicks.

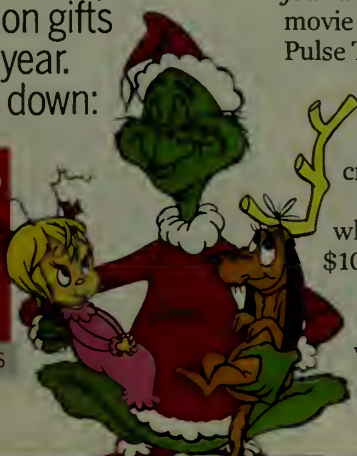
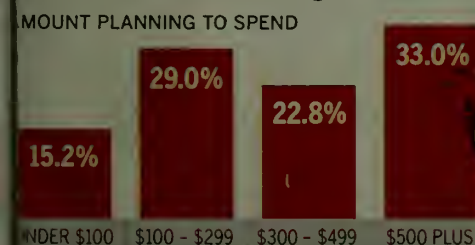
If any soccer player can break through in the U.S. market, it's Beckham, 29, who has graced the covers of *Vogue*, *Men's Journal*, and *Vanity Fair* and lent his name to the surprise hit movie *Bend It Like Beckham*. The David Beckham Predator-Pulse Thumbprint soccer shoe and a collection of blue-and-white athletic apparel are just hitting selected U.S. retailers. In a few months, a line of Beckham casual and active wear will follow—the first time adidas has created a signature brand and logo for one of its athletes.

Adidas execs hope Beckham can do for the company what Michael Jordan did for **Nike**. They pay him more than \$100 million under a lifetime contract, and a further \$10 million annually until 2008 for this deal. The apparel and logo are meant to give the Beckham brand legs well after his are too slow to play pro soccer. Just call it Brand It Like Beckham.

—Stanley Holmes

THE BIG PICTURE

PLAYING SANTA Holiday shoppers expect to shell out an average of \$476 on gifts this season, up 4.5% from last year. Here's how their budgets break down:



Source: The Conference Board's 2004 Holiday Spending Survey of 5,000 households taken in November, 2004

UP Front

IPO WATCH

A VEGAS MOGUL CASHES IN SOME CHIPS

THE BIGGEST WINNER in Las Vegas this year could be Sheldon Adelson, a cab driver's son who made his first big score founding the **Comdex** computer trade



show. Adelson placed a big bet in 1999, opening the \$1.2 billion **Venetian Casino Resort**. Now he's planning to cash in with an initial public offering of stock in **Las Vegas Sands**, the enti-

PAYDAY Adelson will build more casinos

ty that controls his casinos.

According to a Nov. 24 **SEC** filing, the offering would value Adelson's remaining 88% stake at more than \$6 billion. The estimated \$500 million in proceeds from the IPO will help Adelson finish the Palazzo, a \$1.6 billion casino resort he's building adjacent to the Venetian.

But another jackpot lies overseas. Las Vegas Sands is

one of three owners of casino licenses on the island of Macau, the former Portuguese colony that is China's only market for legalized gambling. Adelson, 71, opened one casino there last May and plans to build a

second, a \$1.8 billion knock-off of the Venetian, by 2007. In blackjack they call that doubling down.

—Christopher Palmeri

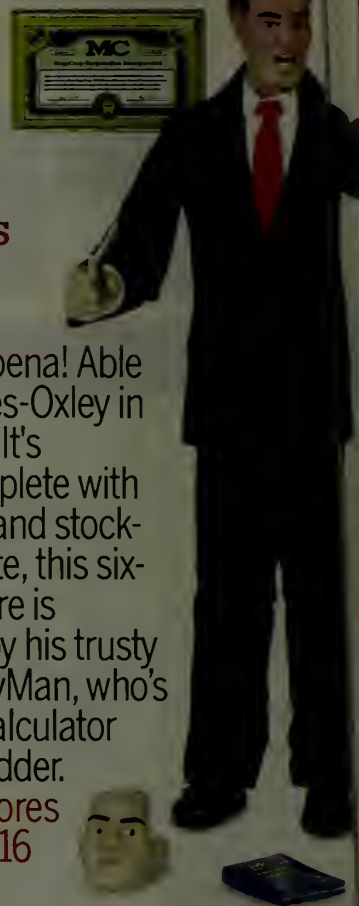
TOY STORIES

POWER PLAY

Faster than a speeding subpoena! Able to leap Sarbanes-Oxley in a single bound! It's **BossMan!** Complete with tiny cell phone and stock-option certificate, this six-inch action figure is accompanied by his trusty sidekick, **MoneyMan**, who's armed with a calculator and paper shredder.

Appearing in stores this month at \$16 to \$18 apiece,

they're the brainchild of husband-and-wife team Kris Schantz, 27, and Shirley Yee, 27, tech-world refugees who started **Happy Valley** two years ago in Toronto. Their first action figure was **GeekMan**, an über-nerd with "the ability to create tech acronyms." —Robert McNamara



PARALLEL PERK DRIVE GREEN AND GET SOME GREEN

IN AN EFFORT to clear the air, **Hyperion Solutions**, a Sunnyvale (Calif.) maker of business software, is offering workers \$5,000 each toward the purchase of a "green" car that gets 45 mpg or better. "[It's a] vote for the environment," says Chief Executive Godfrey Sullivan. The idea popped into his head last July as his thoughts drifted during a 100-mile horse race near Lake Tahoe.

Sullivan has allotted \$1 million a year for the give-away—a smidgen for the \$670 million company—and thinks that his 500 employees could benefit. —Brian Hindo

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FACE TIME VIVEK PAUL



AT LEAST HE GETS SOME RESPECT

Vivek Paul, CEO of Indian outsourcer Wipro and one of India's highest-paid execs, says he's feeling poor. His salary—\$460,000, with a bonus bringing the total to over \$1 million—is low compared with those of his Silicon Valley neighbors of 25 years.

The CEOs nearby are raking it in: Last year, Apple Computer's Steve Jobs traded options for restricted stock worth \$74.7 million. And Oracle's Larry Ellison made a total of \$40.6 million.

Is Paul, 46, trying to play catch-up? He recently sold most of his Wipro stock for \$7 million. He says that Wipro managers typically do not hold much stock and that he planned the sale. "It has absolutely nothing to do with my outlook," he says, noting a new, five-year contract.

One thing Paul does share with his neighbors is celebrity status—at least in India. "Instead of being ambushed by screaming teenage girls, middle-aged men come to me at airports," he says. That's no surprise. Wipro's \$1 billion business is growing at a 47% yearly clip. —Olga Kharif

CASINO SOCIETY RUSSIAN SLOTS ARE GOING KA-CHING!

OVER AND OVER, the catchy jingle plays, tempting passersby into the slot-machine arcade at the busy Kiev railroad station in Moscow: "Play Jackpot, and live without worries!" Every few feet, another arcade beckons.

Quite a change from communist days, when gambling in Russia was outlawed. Hundreds of casinos opened in the 1990s, catering mainly to rich businesspeople. But in the past few years, the betting bug has bitten the man on the street. The number of slot machines nationwide has doubled in the past year, to 250,000, estimates Deloitte CIS. In 1999 there were only 12,500 in the country.



Mouthwatering returns are driving the investment. Profit margins average 40%, and this year slot-machine owners will pull in some \$2.8 billion in revenues, up from \$1 billion in 2003, according to Deloitte. The key factor behind the takeoff in Russia is favorable regulation. There are few obstacles to acquiring a gambling license, beyond a one-time fee of \$45. Operators pay a fixed tax per machine, set at \$130 a month in Moscow. That's no great burden, considering that a

slot machine generates an average of \$700 to \$1,000 per month.

Parliament is debating a new law that would tighten the licensing requirements and hike taxes. Even so, big industry players from Australia and Asia are sizing up the market. Just 4% of Russians play slot machines compared with 25% of Americans. With odds like that, it's no wonder Russia's slot-machine operators see the market as a sure thing.

—Jason Bu

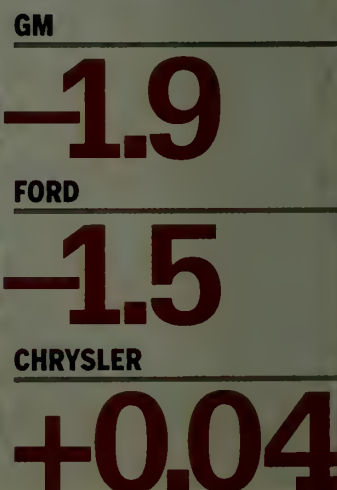
CAR TALK

DETROIT'S FAIR SHARE Twenty years ago, the Big Three auto makers owned 76% of the U.S. market. In October, domestic nameplates—excluding foreign brands owned by U.S. makers—hit a record low of 56.5%. Despite huge incentives, GM has been giving up the most market share. Chrysler has been making small share gains, and Ford is banking on a raft of new cars to help it recoup share over the next few months. —Katie Kerwin

U.S. MARKET SHARE



CHANGE IN MARKET SHARE*

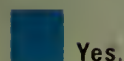
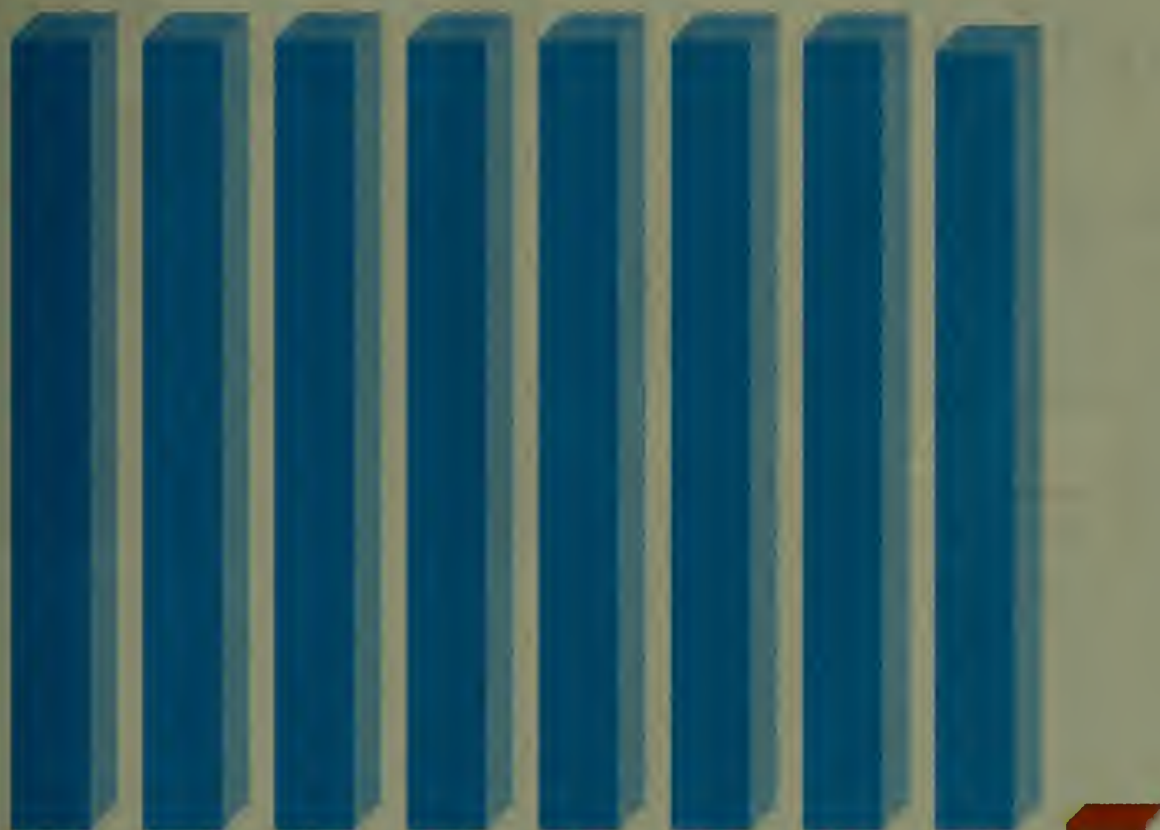


*Change in share of U.S. light-duty vehicle market for October 2004

Data: E

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The Great Innovators

CELEBRATING



As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

DNA's Mapmaker

WHO COULD EVER HAVE imagined that a surfer working as a night clerk at Sears, Roebuck & Co. would eventually become the driving force behind the race to read the genetic code of humanity? That's the unlikely story of J. Craig Venter, a brash biologist who engineered a major leap in scientific knowledge—and earned

millions—by masterminding efforts to probe the DNA of everything from microbes to man.

Venter might not have broken his surfing habit were it not for the Vietnam War, he says. Faced with the draft, he enlisted in the U.S. Navy and ended up as a medical corpsman patching wounds in a hospital in Da Nang. “I got a lifetime of education packed into one year,” he recalls.

He came back to the U.S. energized and ambitious, zipping through college and a PhD in six years and landing at the National Institutes of Health in 1984. At the time, scientists were spending years finding individual genes. But Venter had a better idea. He quickly fished out the copies of many genes that cells make and use in the production of proteins. Then he employed a new sequencing machine to analyze the code in these genes rapidly.

Soon Venter had sequenced parts of hundreds of genes—and became the center of a firestorm when the NIH filed patents on them. “Outrageous,” fumed Nobel Laureate James Watson, co-discoverer of DNA's structure. He charged that Venter's semi-automated operation “could be run by monkeys.” Venter was unrepentant. “I had three strikes against me,” he recalls. “I had a radical idea, it worked, and I was an outsider.”

Venter then became even more of a maverick. He snared venture capital bucks to set up his own nonprofit research institute, linked to a company called Human Genome Science (HGS) that would get first crack at the genes he found. There he pioneered a technique dubbed “whole genome shotgun sequencing” to read all the DNA in an organism quickly, not just

Craig Venter's maverick approach opened the floodgates of genomic information



the 2% in the genes themselves. The NIH rejected Venter's grant application, but he went ahead anyway and in 1995 completed the first full sequence of a living organism, a microbe.

Next, Venter took aim at the biggest quarry of all, the human genome. In 1998 he teamed with toolmaker PE Corp. to set up a company named Celera Genomics. In just three years, he proclaimed, Celera would use the shotgun approach and scores of sequencing machines to decipher humanity's entire genetic code.

It was a direct challenge to the government's well-funded Human Genome Project which immediately stepped up its pace. Despite a face-saving joint announcement at the

White House on June 26, 2000, indicating that both teams had completed a draft of the genome, Venter actually beat the taxpayer-funded project soundly. Not surprisingly, one batch of the DNA Celera sequenced came from Venter.

Like other genomics companies, Celera fell into disfavor on Wall Street when it became clear that finding genes doesn't lead directly to drugs. In early 2002, Venter was fired—though he had already plotted his exit. Now 58, he is full of ideas, such as fashioning man-made microbes to produce hydrogen or suck carbon dioxide out of the air to combat global warming. He may have ruffled too many feathers to get the Nobel prize many scientists think he deserves. But Venter, more than any other individual, is responsible for the flood of genomic information that is expected to transform medicine and our lives.

—By John Car

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It's Been a Privilege

DEAR READERS: AFTER MORE THAN 20 YEARS as editor-in-chief of *BusinessWeek*, I will step down on Apr. 1, 2005. I am leaving to become the founding dean of a new Graduate School of Journalism at the City University of New York. The first class will arrive in August, 2006. My task is to help develop an

innovative curriculum, hire a strong faculty, recruit promising students, and design a physical space for the school, which will be located in the old New York Herald-Tribune building on West 41st Street in Manhattan. I also hope to do some teaching. And, inevitably, I'll try to raise some money for the school.

This exciting challenge combines many of the things I care deeply about: journalism, public education, and New York City. Not least, it offers the chance to increase the participation of minorities and immigrants in our profession. I am a graduate of the City College of New York, and this new role stirs my soul. I'm excited by the prospect—and a little nervous.

Naturally, leaving *BusinessWeek* is a wrenching experience. I have spent a total of 32 years at the magazine, working with hundreds of wonderful and talented people. I will miss this place—the news, the deadlines, the arguments, and the sheer fun. Above all,

I will miss my colleagues of long standing.

Who will succeed me at *BusinessWeek*? The next editor will be chosen as soon as

possible. Several worthy candidates are being considered, both from inside and outside the magazine. The search—being led by Terry McGraw, CEO of The McGraw-Hill Companies; Bill Kupper, president of *BusinessWeek*; and Scott Marden, head of our media group—is nearly complete. I know all the candidates well and each of them is capable of doing a super job. You will be in good hands. Meanwhile, we will continue to produce the best business magazine in the world and to expand the franchise around it.

It's been a profound pleasure to serve so many loyal readers.

Thanks for everything.



STEVE SHEPARD

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Readers Report

“The merger plans of Kmart Holding Corp. and Sears, Roebuck & Co. highlight Lampert’s flair for recognizing and creating value”

—Ron Allen, St. Louis



THE FINANCIER OF THE HOUR

“THE NEXT WARREN BUFFETT?” (Cover story, Nov. 22), on financier Edward S. Lampert, could not have been better timed. The merger plans of Kmart Holding Corp. and Sears, Roebuck & Co. highlight Lampert’s flair for recognizing and creating value. However, one has to wonder who was looking out for Kmart shareholders during bankruptcy proceedings. As you noted, not long after the company was reorganized, Kmart sold 68 stores for a price that was nearly equal to the value being placed on all of its real estate.

—Ron Allen
St. Louis

“WORKED FOR KMART and Kmart Holding Trust for a total of 18 years and three months. I enjoyed working as a community pharmacist in a retail setting. Lampert’s goal “to keep Kmart humming so it can continue to throw off cash,” with the “program of keeping the lid on capital spending, [and] holding inventory down” made Kmart Holding Trust an employer for whom I no longer wanted to work. Lampert sees the value of Kmart Holding Trust in its cash flow and real estate. I left when I saw that valuing those priorities did not leave much room to value associates and customers. I wish the best for the associates who remain and for the customers who continue to shop at our friendly neighborhood Kmart.

—Dee Renee Chesnut
Lewisburg, Ohio

“EDDIE LAMPERT’S stakes in Kmart and Sears made the announced merger a natural.” What’s next? The merger of AutoZone Inc. and AutoNation Inc.?

—Bill Hochman
Fair Lawn, N.J.

CLOSER LOOK AT JUSTICE SCALIA’S RULINGS

“WHAT THE NEW Court will look

like” (News: Analysis & Commentary, Nov. 22), the discussion of Supreme Court Justice Antonin Scalia’s adherence to a strictly “conservative” legal doctrine is incomplete without noting two landmark cases in which Scalia broke ranks with the entire Court and issued textualist dissents that aptly articulated public opinion—albeit well before their time. In 1989, Scalia issued the sole dissenting opinion in *Mistretta v. U.S.* concerning federal sentencing guidelines. Fifteen years later, Scalia’s witty characterization of the U.S. Sentencing Commission as a “junior-varsity Congress,” once dismissed by both parties as an overly strict interpretation of the Constitution, was adopted by a majority of the Court in *Blakely v. Washington*.

Scalia was alone in his dissent in *Morrison v. Olson*, a 1988 case in which the Court upheld the independent counsel provision of the Ethics in Government Act. Although Scalia was heavily criticized at the time, a narrowly divided Congress chose not to renew the independent counsel provision when it expired a decade later.

—Colin Sheldon
Stratford, Conn.

DON’T FORGET ABOUT THE INVESTORS

IT IS FUNDAMENTALLY flawed to base a ranking on the opinions of chief financial officers and audit-committee chairmen (“Auditing the auditors,” People, Nov. 22). The job of the auditor, along with the Securities & Exchange Commission and the Justice Dept., is to attempt to prevent CFOs, audit-committee chairmen, and other executives and board members from putting in the public domain financial statements that are materially misstated (whether by error or by fraud). The auditing-services market is unlike the prior markets J.D. Power & Associates has surveyed. Although the corporation pays the audit fee, the con-



TOSHIBA

Don't copy. Lead.

CORRECTIONS & CLARIFICATIONS

In "The next Warren Buffett?" (Cover Story, Nov. 22), the kidnap vehicle was a Ford Expedition.

In "India's PM reaches out to Kashmir" (Global Wrapup, Nov. 29), the first sentence should have read: "Indian Prime Minister Manmohan Singh made an important peace overture on Nov. 17 in Kashmir, the violence-torn territory claimed by both New Delhi and Islamabad."

sumers of the audited financial statements are the investors, bankers, and others outside the corporation.

—Ross D. Fuerman
Suffolk University
Boston

KEEPING THE BANKRUPTCY SYSTEM FAIR

AS A BANKRUPTCY litigator having defended and brought hundreds of "preference" suits, I could not help but notice "The long arm of failure" (Finance, Nov. 15). My concern is that your article will help turn yet another section of the bankruptcy code into a target for lobbyists, all of whom will seek exceptional treatment for their politically connected clients at the expense of the overall bankruptcy system, which should be creditor-neutral to be fair.

—Earl M. Forte
Philadelphia

DON'T BLAME PUBLIC UNIVERSITIES FOR POLISHING THEIR IMAGE

PUBLIC UNIVERSITIES are attempting to maintain or gain "elite" status precisely to keep the fraction of total costs paid by students as low as possible ("Should public universities behave like private colleges?" Social Issues, Nov. 15). The lion's share of federal research support goes to the "elite" institutions. Similarly, private support of universities goes to the same group of institutions. I suspect that few of your readers believe that government-owned institutions can be more efficient than private institutions. Why, then, should you believe that it is less expensive to operate a state-supported university than a private one? Clearly only a few public universities not already among the elite group will be able to raise their profile, but can you blame them for trying when that is the only way to slow the rise in tuition?

—Gary Thomas, Chancellor
University of Missouri
Rolla, Mo.

SERENDIPITY IN TREATING RIVER BLINDNESS

YOUR READER JUDY ROSNER got it right about the difficulties posed by vaccine development by big pharmaceutical companies ("The woes of U.S. drugmakers," Readers Report, Nov. 15, replying to "booster shot for vaccines," News: Analysis & Commentary, Oct. 25). However, she did not get it right about Merck & Co. and its development of Ivermectin for river blindness. That drug was created to treat parasitic diseases in large farm animals (cattle, horses, and sheep), the market for which is huge worldwide. That was the motivation and payoff. It happens that it also works for river blindness. Merck kindly supplies the drug free of charge, and it is mainly distributed by the Carter Center.

—Roland H. Ingram Jr., M.D.
Atlanta

BREAKING THROUGH MEXICO'S GRIDLOCK

"HOW CHINA opened my eyes" (International Business, Nov. 8) has described well Mexico's situation compared with China and the rest of the world. Mexico is in paralysis—our government is profoundly divided among the three major parties: PAN, PRI, and PRD. There have been serious attempts at reform, but they have been rejected in an extremely politically charged environment in both houses of Congress. It's impossible for a President to govern with such a divided Congress, and that will continue. Political reform should include, instead of a President, a figure more like a Prime Minister ensuring for the executive branch a majority in Congress that would let him or her govern and give coherence to the economic and social systems.

—Divo Mila
Mexico City

How to reach BusinessWeek

LETTERS FOR READERS REPORT

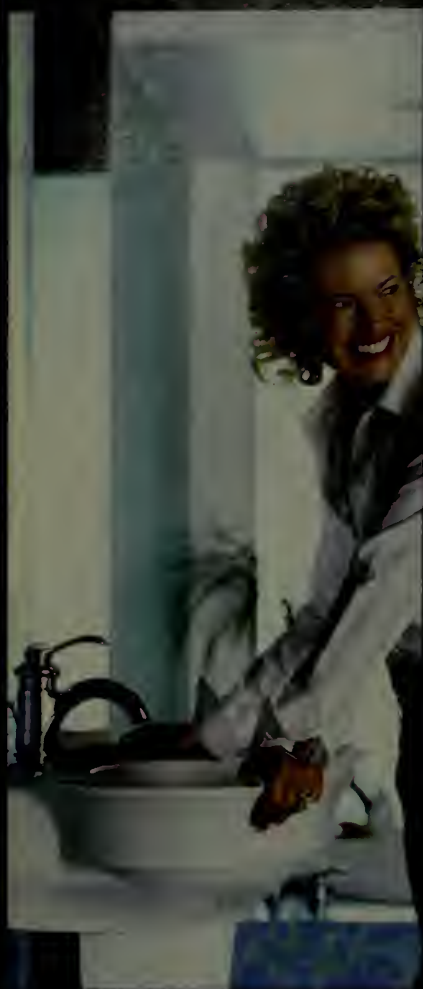
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The Pick of This Year's Crop

Choice, like freedom, can be a burden. But in an election year, it seems appropriate that the act of choosing should be a major theme in several of the top 10 business books of 2004 as selected by *BusinessWeek* reviewers. For example, James Surowiecki argues that decisions made by a group are often better than

those made by the smartest man or woman alone. In the provocative **The Wisdom of Crowds: Why the Many Are Smarter Than the Few and How Collective Wisdom Shapes Business, Economies, Societies and Nations** (Doubleday), the *New Yorker* staff writer provides numerous example to support this thesis, and cites the backing of social scientists who salute "decentralized self-organizing systems," such as Adam Smith's invisible hand. Moreover, he tells when tapping into the crowd pays off big and why the group can go wrong, as when stock-market speculation spirals out of control. Although the author isn't always convincing, reviewer Christopher Farrell found that "he musters ample proof that the payoff from heeding collective intelligence is greater than many of us imagine."

What if the cornucopia of choices facing all of us becomes overwhelming? Barry Schwartz's **The Paradox of Choice: Why More Is Less** (Ecco) describes how Americans are increasingly flummoxed by the necessity of selecting from a vast and growing number of alternatives in almost every sphere of life, from consumer goods to 401(k) investments to religion. The professor of social theory at Swarthmore College provides a survey of social scientists' research into how people make these judgments: We learn why the most diligent pre-choice research tends to get trumped by anecdotal evidence, such as a friend's recommendation, and why consumers sometimes cannot decide and leave the store empty-handed. Schwartz exaggerates a bit, as when he links rising societal levels of depression to the "relentless" experience of disappointment over decisions made. On the



whole, however, his book is absorbing, witty, and persuasive.

To respond to forces that are shaping consumer behavior, corporations may need to partner with their customers, say C.K. Prahalad and Venkat Ramaswamy in **The Future of Competition: Co-Creating Unique Value with Customers** (Harvard Business School Press). Only by letting individual corporate customers and consumers fashion products and services will business leaders escape the trap in which their products' or distinction is price, say the two professors at the University of Michigan Business School. Reviewer Steve Hamm found that the "provocative" book lays out "how to change organizational behavior to make co-creation natural rather

Our Top 10*

ALEXANDER HAMILTON by Ron Chernow

CONFRONTING REALITY *Doing What Matters to Get Things Right* by Larry Bossidy and Ram Charan

FREE CULTURE *How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity* by Lawrence Lessig

THE FUTURE OF COMPETITION

Co-Creating Unique Value with Customers by C.K. Prahalad and Venkat Ramaswamy

IN DEFENSE OF GLOBALIZATION

by Jagdish Bhagwati

MEDIA MAN *Ted Turner's Improbable Empire* by Ken Auletta

MY LIFE AS A QUANT *Reflections on Physics and Finance* by Emanuel Derman

ORIGINS OF THE CRASH

The Great Bubble and Its Undoing by Roger Lowenstein

THE PARADOX OF CHOICE *Why More Is Less* by Barry Schwartz

THE WISDOM OF CROWDS *Why the Many Are Smarter than the Few and How Collective Wisdom Shapes Business, Economies, Societies and Nations* by James Surowiecki

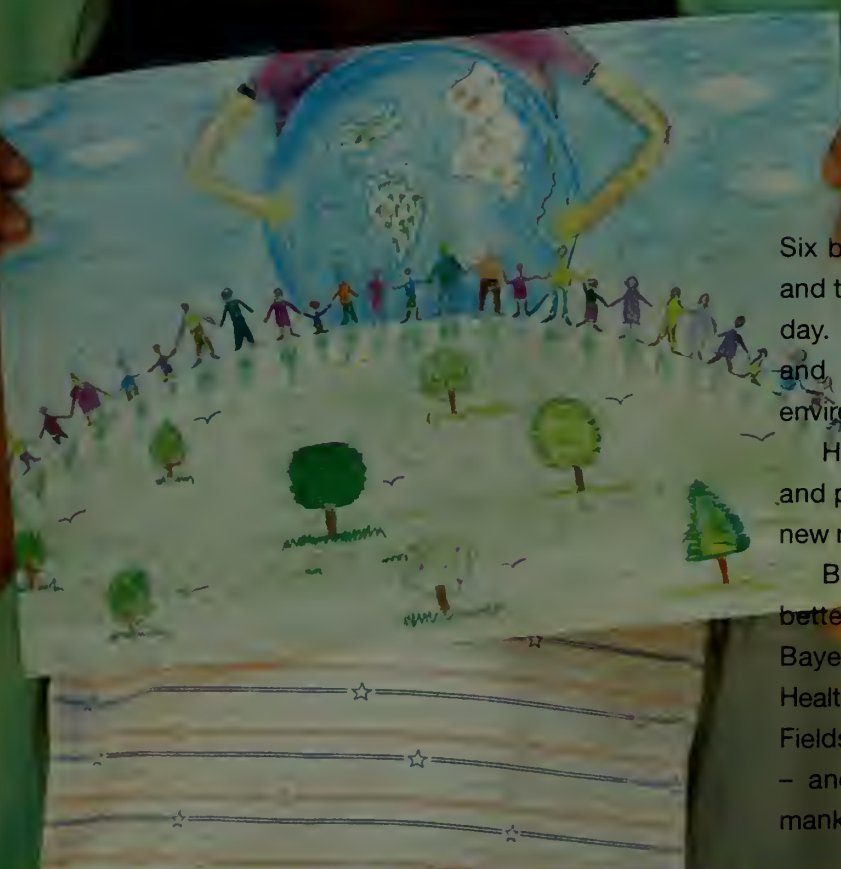
*In alphabetical order by title

Exploring Life



Fulfilling Dreams

Science For A Better Life



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than an isolated, heroic act." The authors have sweeping change in mind: Alterations must be made to every corporate function, from product development to sales and marketing. Indeed, what the duo contemplates is nothing less than the democratization of commerce.

Perhaps the most profound and polarizing tremors shaking the business world involve international trade, outsourcing, and economic development in less fortunate areas. In **Defense of Globalization** (Oxford University Press) by Columbia University economist Jagdish Bhagwati, which reviewer Peter Coy called "a forceful but nuanced" brief for free trade, recognizes that such phenomena are hardly all to the good. Yet Bhagwati insists that globalization can be a positive influence when guided by enlightened government policies. "Trade enhances growth, and... growth reduces poverty," he says, grounding the argument in statistics and real-world evidence. A recurring theme is that globalization unfairly takes the blame whenever something bad is going on, from the erosion of indigenous cultures to mistreatment of women and children to environmental damage.

What else does it take for a company to be a winner in a changing world? That's the question addressed in **Confronting Reality: Doing What Matters to Get Things Right** (Crown Business), by former Honeywell International CEO Larry Bossidy and management guru Ram Charan. The authors offer a model for facing facts in three areas—external realities, internal realities, and financial targets—helping readers to see how these are linked and how to reassess them. They provide several case studies that hold lessons about what to change and what not to change. And they conclude with tips on how to prepare an organization for transformation. "The busy authors have managed to bring fresh insights to a matter that's high on the corporate agenda," observed reviewer Diane Brady.

Some of the protagonists in the year's best business books are familiar to everyone. *New Yorker* writer Ken Auletta profiles one of the most colorful in **Media Man: Ted Turner's Improbable Empire** (Atlas Books/Norton). Lots of ink has been spilled to describe Turner's creation of Cable News Network, his career as a yachtsman, and myriad other successes. But Auletta shows us something new—a Turner who lost his power and maybe even his way after 2000. In that year, he was shut out of merger talks and later stripped of his vice-chairman title at what would soon be called AOL Time Warner. We also see a new Ted—one driven by philanthropic interests, anxiety about the spread of nuclear weapons, and concerns about the clout of Big Media.

Are such large media companies stifling innovation? Stanford University law professor Lawrence Lessig suggests that they are in **Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity** (Penguin Press). Lessig notes that new technology—including file-sharing software, CD recorders, and e-mail—tends to undercut corporations' control, enabling the public to make many copies of original works. Companies holding copyrights have responded by suing users, startups, innovators, and hobbyists. They have gotten statutes passed outlawing the breaking of copy-protection technologies. No matter what the reason. Meanwhile, the author worries that

the debate is being oversimplified—as being just between the pirates and those who favor property rights. All innovation involves some imitation, he suggests, and argues that the owners of intellectual property are claiming rights that they never had in the past.

At times the value of new thinking gets exaggerated—as with some of the tech companies that were hyped during the 1990s. That period is the subject of Roger Lowenstein's **Origins of the Crash: The Great Bubble and Its Undoing** (Penguin Press), which reviewer Marcia Vickers called "a crucial account of an era of excess and folly." The author documents a gradual but momentous shift toward stock ownership that led about half of the U.S. public to invest in stocks by the mid-

'90s. But it wasn't until the advent of the Internet, which spawned "a combination of childlike euphoria and not so innocent greed," that investor delirium appeared. Lowenstein documents how investment bankers, entrepreneurs, and venture capitalists—all hailing the "magical rise" of profitless New Economy companies—wielded unprecedented influence over both inexperienced and sophisticated investors.

Another side of Wall Street can be seen in Emanuel Derman's **My Life As a Quant: Reflections on Physics and Finance** (Wiley), which reviewer Peter Coy called "a literate and entertaining memoir." A victim of academic-world underemployment, Derman bailed out of the halls of ivy for the world of investing. Starting at Goldman, Sachs & Co. in 1985, he moved from fixed-income to equity derivatives to risk management, becoming a managing

director in 1997. The most challenging part of this book is the author's detailed explanation of trading tools: For example, there's the formula for pricing options on Treasury bonds, which he co-invented with Goldman colleagues Bill Toy and the late Fischer Black. But *My Life As a Quant* is not all tough sledding:

With references that range

from Mother Goose to Goethe, it's an amusing tale of one man's unlikely experiences.

Finally, history buffs will enjoy Ron Chernow's **Alexander Hamilton** (Penguin Press), a celebrated biography of the founding father who laid the foundations of the U.S. capitalist system. Chernow traces Hamilton's life from his illegitimate birth on the Caribbean island of Nevis through his death at the hands of duelist Aaron Burr. Like a Horatio Alger hero, Hamilton rose by dint of his talents—as an orator, soldier, and student of finance—and as a result of being in the right place at the right time. A top wartime aide to General George Washington, he later served in the first President's Cabinet as Treasury Secretary. It was there that his prodigious abilities were most on display, as he devised the first U.S. tax and budget systems, the country's first central bank, and its first monetary system. *Alexander Hamilton* offers a glimpse of a man from the past who, in Chernow's words, became "the messenger of America's economic future." ■

—Compiled by Hardy Greer



Running the gamut from Ted Turner to Alexander Hamilton

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BY STEPHEN H. WILDSTROM

Security at the Touch Of a Finger

I have been interested in fingerprint readers as security tools for a long time, but I've been reluctant to recommend them because they were expensive, complicated, and not terribly reliable. That has changed. There's a new generation of low-cost, simple readers on the market that can make computing easier, more secure, or both.

Fingerprint scanners range from optical readers that you use by placing a finger on a window, to "swipe readers," which are built into laptops, handhelds, and even USB memory keys. You use these by running your finger across a bar-like sensor. The optical readers are the simplest, but even the fussier swipe readers rarely misread your finger.

There are two basic uses for fingerprint readers. In corporations or government, they can be integrated with existing authentication systems to control access to the network, either as an alternative or as a supplement to passwords or other devices, such as smart cards. Of more interest to consumers, a fingerprint can be used as a sort of master password to log into your computer and Web sites, music services, and other things that need passwords.

A NEW LINE OF MICROSOFT FINGERPRINT readers for Windows XP, including a stand-alone USB scanner (\$64, \$84 bundled with a mouse) and a version built into a keyboard (\$104), will push optical reader technology into the consumer mainstream. Oddly enough, the software tells you that the reader is intended to be used for convenience, not security—a warning that I suspect will be heeded as much as the one on the Q-tips box that tells you not to stick swabs in your ears. When you start up your PC after installation, it invites you to register one or more fingers by touching the pad four times. After that, you log in simply by touching the pad. If the computer has more than one user, Windows checks the fingerprint to pick the right account. Once logged in, you can use the Password Manager software for additional log-ins. If, say, you want to visit Travelocity, you touch the fingerprint pad and the software automatically uploads your password to the Web site.

While Microsoft is focusing on consumers and home users, other vendors are looking at the corporate and



HANDY
Microsoft's
fingerprint
reader

government markets. Their systems typically tie into Windows Active Directory or other network access systems. Some IBM ThinkPad T42 models (\$1,649 and up) have swipe readers built in just below the keyboard. Depending on the security settings, a fingerprint can be used, with or without a password, to boot the computer, gain access to the hard drive, and log in

to Windows. It can also be used to supply passwords for Web sites.

You can get many of the same functions, at some sacrifice in convenience, from add-on units. DigitalPersona, the company behind Microsoft's products, offers a similar optical reader (\$95) with different software that controls access to networks. The COMBO-Mini (\$179) from Silex Technology

Consumers can use their fingerprints as a master password

America plugs into a USB port and adds a smart card to the fingerprint reader for extra security. The Silex reader had some trouble recognizing my fingerprint, but this was fixed when I turned down its sensitivity setting.

Probably the best way for individuals to use fingerprint readers is to pick strong passwords—the sort someone else would have trouble guessing, but that you might have trouble remembering—then use your fingerprint to pass them on to Web sites and other places that require them. It's a painless route to better security. ■

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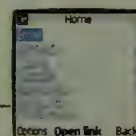
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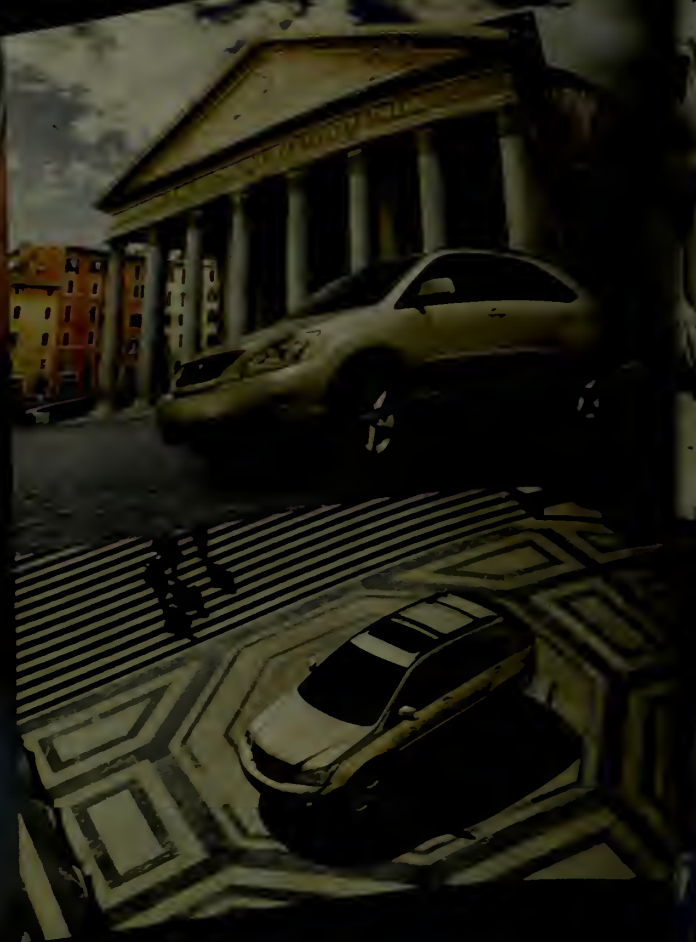
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BY ROBERT J. BARRO

Mysteries of the Gaping Current-Account Gap

Fed Chairman Alan Greenspan recently expressed concern about the stubbornly high U.S. current-account deficit. I share his concern, but I find that understanding it is like unraveling a Sherlock Holmes mystery. There are lots of clues, but I am not enough of a sleuth to put them all together. The current-account deficit is amazingly large, averaging 4.4% of gross

domestic product since 2000. In comparison, during the twin-deficits era of 1984-88, the current-account gap averaged just 2.7% of GDP. The only prior year with a deficit greater than 4% of GDP was 1816, when imports surged following the end of the War of 1812.

The accumulation of current-account deficits has pushed the U.S. to substantial net indebtedness with the rest of the world. Back in 1996 the net international investment position was -4.6% of GDP. At the end of 2003 it reached -24.1%.

A COMMON VIEW IS THAT this debt is piling up as U.S. Treasury bonds held by central banks in Japan, China, and elsewhere. In fact, at the end of 2003 foreign official holdings were still only \$1.5 trillion, or 14% of foreign-owned U.S. assets. Of the \$2.1 trillion increase in such assets from the end of 1999 to the end of 2003, only \$500 billion went into official holdings. But the share of official holdings in total foreign claims has trended upward since 2002.

The rise in U.S. indebtedness should have generated large net payments on assets from the U.S. to the rest of the world. Surprisingly, that hasn't happened. The returns on U.S.-owned foreign assets increased so much relative to those on foreign-owned U.S. assets that the net U.S. income on assets in 2004 is still positive. The puzzle is why foreign investors—not just central banks—are willing to hold so much in low-yielding U.S. assets. America's ability to incur foreign debts, essentially without paying for them, is eroding the normal market forces that correct a current-account imbalance.

The current-account balance is the difference between a country's total income and its spending on consumption and investment (and net transfers abroad). The current account is the difference between national saving—income not spent on consumption—and domestic investment. To think about why the ratio of the current-account deficit to GDP is large, ask why the ratio of investment to GDP is high or why the national saving rate is low.

In the mid-1980s the standard story was that U.S. budget deficits reduced the national saving rate and caused current-account deficits. But the current-account gap vanished by 1991, when the budget deficit was still large. As the budget deficit was being replaced by surplus, the current-account gap returned,

rising to 4% of GDP in 2000. Clearly, budget deficits were not the main determinant of current-account deficits. One does better by considering investment. The ratio of investment to GDP rose from 13.1% during the 1991 recession to 18.1% in mid-2000. This increase in the investment ratio by five percentage points helps explain why the current account went from near zero in 1991 to a deficit of 4% of GDP in 2000. The national saving rate changed little. Added investment was financed by borrowing from foreigners.

The 2001 recession lowered the investment ratio by three percentage points. The current-account deficit fell by a percentage point. The growth in government spending after September 11 raised the current-account deficit in 2002. In

The budget deficit isn't to blame, but spending discipline won't hurt

2003-04, the current-account deficit was boosted by an investment rebound and oil-price hikes.

Many economists think that current-account deficits explain why a broad index fell 17% since 2002. Some predict that the dollar will fall further. But the relationship between exchange rates and current-account deficits is slippery. The broad dollar index appreciated by 14% from December, 1998, to July, 2001, despite large U.S. current-account

deficits. Futures contracts forecast a depreciation of the dollar against the euro by only 0.5% over the next year. If current-account deficits predict a falling dollar, the financial markets have yet to figure this out.

The greatest threat from the yawning current-account deficit is that the government will follow bad policies to fix things. Washington could lower the current-account deficit with spending discipline. It would be bad to respond to the falling dollar by limiting free trade or diverting monetary policy from maintaining low and stable inflation. ■

Robert J. Barro is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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Businesses Are Betting On a Happy New Year

Companies feel better about the future and are ready to expand

U.S. ECONOMY Businesses appear to be casting off their summer caution, and that's good news for 2005. Earlier this year, the oil shock and election uncertainty clouded the outlook, causing companies to delay some of their inventory-building, capital projects, and hiring until the future was a little clearer. Now, companies seem to like

what they see, especially the rebound in consumer spending and the lower dollar, which will provide a boost to exports and profits.

As a result, Corporate America is gearing up once again. Just look at the rising trends in industrial orders and output, suggesting that companies are responding to a stronger pace of demand. More important, companies appear to be interested in expanding their operations, not just in replacing tired old computers or machinery. Growing payrolls are another key sign that, despite the high cost of hiring, businesses are feeling better about the future and are willing to expand. All this is supporting economic growth this quarter, and the momentum could carry over into the new year.

The reason businesses are increasingly willing to shell out more for equipment and payrolls is evident in the details of the Commerce Dept.'s Nov. 30 update on third-quarter real gross domestic product. Based on more complete data, Commerce says the economy grew at a 4.9% annual rate over the summer, instead of the 3.7% rate originally reported last month. And while the overall revision to the past was small, the underlying data show a sharp upward shift in prospects for the future.

As it turns out, overall demand last quarter was stronger than first reported. Spending in all sectors—consumer, business, government, and foreign trade—grew at a 4.9% annual rate. That's up from the 4.2% pace at the initial data and the best showing of the year. At the same time, businesses built up their inventories by less than first estimated. With inventories lean, output will have to be boosted to meet rising demand. And that's just what's happening, based on the November gain in the Institute for Supply Management's index of industrial activity. All this implies further growth in jobs, income, and spending.

THIS VIRTUOUS CYCLE explains why many companies are starting to look at expansion plans. The Business Roundtable's latest CEO Economic Outlook Survey shows that executives expect the economy to grow at a healthy pace in the first half of 2005. Moreover, 50% of the CEOs surveyed expect their companies to increase capital spending in the next six months. That percentage is well

above the 35% from this time last year, and it has risen steadily in each quarter this year.

The upturn in capital spending got its start when companies began to replace aging, short-lived tech equipment. During the first two years after the recession ended, spending on information-processing gear accounted for 70% of the growth in overall equipment outlays.

But in the past year, with industrial operating rates rising and with demand strengthening, businesses have boosted their spending for more traditional machinery and equipment. Third-quarter business outlays for all types of equipment and software, adjusted for inflation, increased at a sturdy 17.2% annual

rate, faster than the 14.9% pace first reported. Outlays for info-processing equipment slowed last quarter, but spending on nontech items accelerated sharply. Industrial machinery was up 27.2%, the best showing since Commerce started keeping quarterly records on such spending in 1990. Transportation equipment soared 35.4%, the largest quarterly gain in nearly six years. And spending on all other nontech items jumped 22.9%. As a result, in the past year nontech equipment has accounted for nearly 60% of the growth in all equipment outlays.

THAT TREND IS CONTINUING this quarter. Machinery orders posted a strong gain in October, the third in a row, while transit equipment saw a small rise. Total orders for capital goods, excluding aircraft, fell 3.6%, but that followed a 5.2% jump in September. Looking past the monthly ups and downs, the trend in orders is clearly on the upswing, following the summer pause (chart). In addition, shipments of capital goods began the quarter with a hefty gain, suggesting business outlays are on track to post another solid advance this quarter.

Despite the recent interest-rate hikes by the Federal

CAPITAL GOODS: STILL IN AN UPSWING



Reserve, financing this spending won't be a problem. Corporations have enough cash flow to cover all their capital outlays and then some. True, profits will grow more slowly as costs rise, but that's compared with the superstrong pace of recent quarters. Third-quarter profits from current production, as measured by Commerce, fell 2.4% from the second quarter, and the growth from the previous year slowed to 8.4%, vs. 19% in the second quarter. But hurricane-related payouts by insurance companies and uninsured losses subtracted nearly \$80 billion from the total. Excluding that, profits last quarter would have grown 4.4% from the second quarter and 16% from the year before.

A more critical question mark for capital spending is the yearend expiration of the 50% "bonus depreciation" allowance granted companies in the 2003 tax package. Businesses have an incentive to get their spending done before Dec. 31, and the worry is that any bunching of outlays may borrow from spending in early 2005.

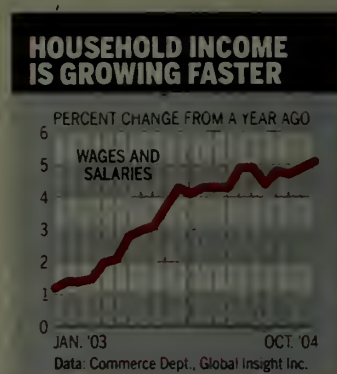
But a survey of companies done by the Philadelphia Federal Reserve Bank, along with the latest reading of spending plans in the Business Roundtable survey, suggest little if any impact. Moreover, the level of unfilled orders for capital goods continues to trend higher, suggesting further gains in shipments are on the way.

COMPANIES HAVE TO BE PLEASED by the way consumers have bounced back from the initial impact of the oil shock. Commerce now says consumer spending grew at a 5.1% annual rate last quarter, the strongest

advance in nearly three years. Clearly, higher energy prices have hit households. But important offsets are coming from better job growth, which is boosting incomes (chart), and sizable gains in household wealth, which is lifting borrowing power.

Last quarter's spending increase is a reminder that

consumers' actions don't always line up with how they say they feel. The Conference Board's index of consumer confidence has fallen steadily since July. In November it slipped to 90.5 from 92.5 in October. And for the second month in a row, households said they have diminished expectations for the future. But October non-



auto retail sales were strong, and the holiday shopping season appears off to a decent start (page 36).

The continued upbeat trend in demand, the ongoing rise in capacity utilization, the excellent financial condition of corporations, and the rebound in outlays for traditional machinery all support the notion of a positive outlook for capital spending. And historically, capital spending and job growth have moved in tandem. Given that combination, the economy is most likely on its way to a happy—and prosperous—new year. ■

CANADA

A Stronger Currency Is Curbing Growth

CANADA IS SEEING how a strong currency can tap the brakes on economic growth. But unlike central banks elsewhere, the Bank of Canada seems to welcome the slowdown.

Third-quarter real gross domestic product expanded by 3.2%. Growth was curbed by a drop in exports, the first quarterly decline in a year, following rapid increases in the first half. The fall reflected a slowing in auto shipments and a stronger Canadian dollar, which has surged some 28% against the U.S. dollar since 2002.

Although the GDP increase was less than economists had expected, it marked the fourth quarter in a row in which real GDP grew above its 3% potential rate, the

pace the economy can grow without generating inflation pressures. In late November, Bank Governor David A. Dodge told the Senate that the first-half gain in exports meant the economy is now "operating near its production capacity." As a result, inflation pressures could be building.

In October energy prices pushed overall yearly inflation to 2.3%, above the bank's 2% midpoint target. The

core rate, which excludes volatile items including food and energy, stood at 1.4%, down from September's 1.5%.

What worries policymakers is that, with the economy carrying little excess capacity, inflation will not slow next year as the BOC expects.

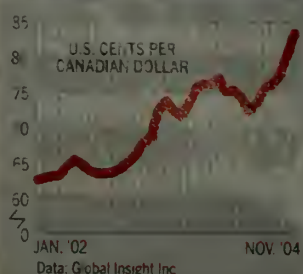
Despite the third-

quarter slowdown, Dodge's comments support the view that the BOC will raise its target for the overnight rate by a quarter-point, to 2.75%, at its Dec. 7 meeting. It would be the third hike in four months.

But policymakers are well aware that the strong dollar is doing some of the work needed to put a brake on growth. As the GDP report shows, the increase is curbing foreign demand for Canadian goods, especially from the U.S., which buys 80% of its northern neighbor's exports. And Canadian exporters are finding it harder to compete against American companies in emerging nations.

Because of the currency's drag on exports, analysts are revising their forecasts for monetary policy. Instead of a steady string of hikes in 2005's first half, which would follow the expected path of the Federal Reserve the Bank of Canada may only have to raise rates once or twice next year. ■

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RETAILING

PLAYING THE DISCOUNT GAME

Stores offering deep sales after Thanksgiving did well. But will promotions translate into profits?

FOR SHOPAHOLICS, IT WAS A Thanksgiving weekend to remember. Stores from Kohl's to Sears to Circuit City opened their doors as early as 5:30 a.m. the day after the holiday as retailers poured on the promotions and other incentives to lure shoppers. J.C. Penney Co. promoted \$10-off coupons and three-carat diamond bracelets for \$299. Target stores made wake-up calls to customers. But perhaps the best deal of all came from office-supply giant Staples Inc. Not only did shoppers get \$130 DVD drives for \$40, the chain also handed out 50,000 paper shredders and 80,000 surge protectors that were essentially free.

It's as if the entire retail sector has taken a page from Wal-Mart Stores Inc., opening

early and offering a range of low-priced goodies aimed at getting shoppers in the door. Everyone seems to be on board, except, that is, Wal-Mart itself. The world's biggest retailer pulled back this year on its usual post-Thanksgiving promotions in a bid to shore up margins—only to see sales suffer and its stock suffer as a result. Even Wal-Mart seems unable to hit the brakes on the ever rising levels of deals, discounts, and enticements that have become every shopper's favorite Christmas present. Retailers hope, of course, is that once tempted inside, shoppers will buy the less-heavily discounted merchandise, too. The risk is that all the deals simply hike sales at the expense of earnings.

With Wal-Mart now on the defensive, however, one thing is clear: Discounts will continue to be the order of the day. After all,

why argue with success? ShopperTrak, which tallies results from 30,000 outlets, found that sales were up a strong 10.8% compared with a year earlier on Friday, the day stores let loose with promotions. Says Marshal Cohen, chief industry analyst for marketing information tracker NPD Group Inc.: "It's very evident that retailers that promoted got the business."

The question is whether the hefty promotions are pulling sales from later in the buying season or otherwise undercutting full-priced sales. On that mark, results look mixed. In a phone survey of shoppers on "Black Friday"—the day many retailers traditionally move into the black—Atlanta-based consumer researchers America's Research Group found that 73% of shoppers who went to a store for a promotional item also put other goods in

SO IN THIS SECTION:

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- 46 | Just how cheap is Chinese labor?



WAL-MART Will high prices crimp spending of its low-income customers?

their shopping cart, up from 62% in last year's survey. Researchers also found that some 60% of customers who shopped over the holiday weekend intend to return to the stores they've already frequented. "If you won on [Black] Friday, you have your best foot forward, and you're likely to do well for the season," says founder and Chairman C. Britt Beemer. "If you struggled on Friday, you'll have a tough time regaining your footing."

Yet for all the success on Friday, sales on Saturday and Sunday—when discounts were less plentiful—came in far weaker. Overall, the weekend's sales were up only 2.9% from last year, according to ShopperTrak. The clear lesson: Americans have learned to buy on promotion. "Retailers are training us to buy on Black Friday, and they're doing it by offering very aggressive discounts," says Edward Fox, director of the J.C. Penney Center for Retail Excellence at Southern Methodist University. "We'd be kind of foolish to ignore that, so we don't."

WHERE'S THE HOT MERCH?

SO WHAT WILL KEEP shoppers coming into the stores rather than waiting for a rush of big sales in the final days before Christmas? No surprise there: Retailers have a wave of promotional offers planned for the weeks to come. Bloomingdale's has mailed out coupons to shoppers for \$25 off any \$100 purchase next week. At Restoration Hardware, which has done little discounting so far, customers will get 20% off their entire purchase on Dec. 5 and 6. And CompUSA will offer hundreds of dollars off

Gateway PCs and Toshiba laptops through early December.

Will it be enough? One reason price is so important is the dearth of hot merchandise. Digital cameras, iPods, and

other electronics gear have earned good buzz this year, as have some luxury items such as pricey handbags and brooches. Otherwise, retail experts don't see much calling customers into stores beyond the heavy discounts.

Still, shoppers seem to be willing to open their wallets. Although gas and oil prices are high, consumer spending seems yet to be affected. On Dec. 1, the Commerce Dept. reported a 0.7% gain in consumer spending in October, the second such rise in a row. Disposable income, salaries, and wages were all up as well. Overall, marketing researchers NPD Group projects that retail sales for the holiday season will be up 3.8% this year, roughly in line with 2003's performance.

But if sales are strong, what will the blowout deals do to earnings? For now retailers remain optimistic. Many appear to be doing a better job managing their inventories and pricing than they did for many a Christmas past. They started planning these sales months ago and are largely limiting the discounts to promotional items procured at a decent price—often from China. Staples, for example, began negotiating for good deals on cameras and electronics 18 to 25 months ago, and the chain expects to be profitable in December. Inventory levels across the board are thought to be relatively lean, minimizing the need for panic sales over the next few

weeks. Retail analyst Robert F. Buchanan of A.G. Edwards & Sons Inc. expects retail profits to grow 15% for the fourth quarter. "What's driving that is very tightly controlled inventories," he says.

Of course, much depends on what Wal-Mart does in the coming weeks to regain momentum. If the retail giant cuts prices broadly, rivals could have a hard time keeping up. In electronics, where Wal-Mart held back on promotions, category killers such as Best Buy and Circuit City Stores Inc. kept their early discounts roughly in line with 2003 levels. They were also able to cut back on their 0% financing offers, according to Goldman Sachs & Co. analyst Matthew J. Fassler. But if Wal-Mart comes out swinging such pricing discipline could fade.

But it won't be easy for Wal-Mart to slash prices. While many analysts figure the discount behemoth will do what it takes to get sales back on track, its weak November performance has left some wondering. The Bentonville (Ark.) chain faces rising labor and other costs, which are already pressuring margins. At the same time, rivals such as Target have reduced the gap between their prices and Wal-Mart's on many items. Both factors could limit the room Wal-Mart has to cut prices enough to make a difference. Says analyst Emme P. Kozloff of Sanford C. Bernstein & Co.: "[Wal-Mart] caught between a rock and a hard place. Even if the chain does drop prices further, the move may not be as effective in spurring sales as in the past. High gas prices may be crimping spending plans, its generally low-

PC ANYONE?
CompUSA's deals didn't end after Thanksgiving

come customers.

The biggest shopping days of 2003 are yet to come. According to Visa International, last year the biggest day was Dec. 2, when procrastinators shelled out \$4.1 billion. That leaves lots of hunting and gathering to be done before it becomes clear who this holiday's winners and losers will be. ■

—By Nanette

Byrnes in New York and Wendy Zellner in Dallas, with Louisa Lee in San Mateo, Calif., Ann Thayer Palmer in Chicago and bureau reporters

Retailers appear to be managing inventories better than in years past

Deals, Deals, Deals

Retailers high and low are stealing Wal-Mart's thunder with big, early discounts



SEARS

Gave \$10-off coupons to the first 200 shoppers in mall stores nationwide

J.C. PENNEY

Opened at 5:30 a.m. over Thanksgiving, with specials on diamond bracelets

RESTORATION HARDWARE

Offering 20% discount for all purchases on Dec. 5 and 6

STAPLES

Rolling out weekly specials on digital cameras and handing out freebies

BLOOMINGDALE'S

Mailing out coupons for \$25 off of every \$100 purchase into December



PRICEY Many cards carry 13% interest, vs. 3% to 7% for home-equity loans

there's little sign that the avalanche of offers will slow. "You can count on that lasting," says Robert K. Hammer, who heads his own bank-advisory firm in Thousand Oaks, Calif. "It continues unabated."

The double whammy—first from the refi boom and now from the home-equity loan craze—is clearly taking a toll. Pumped up by consolidation, pretax profits for the industry's seven biggest card issuers are growing at a heady 29.2% clip this year, but that rate will likely slow sharply to 18.8% next year, forecasts Credit Suisse First Boston analyst Moshe Oren-

buch. Morgan Stanley expects credit-card companies this year to lose some \$17 billion in receivables to mortgage refinancing and \$89 billion to home-equity loans. "People have been consolidating a lot of debt, and they've been using their home equity to do that," says Greg McBride, a senior financial analyst at Bankrate.com, a firm that tracks the card industry.

VARIABLE RATES, HIGHER PROFITS

TO FIGHT OFF the profit squeeze, plastic merchants are trying to impose higher rates. Their preferred strategy: shifting customers to variable-rate cards, whose

rates can change without notice, instead of fixed-rate cards whose customers must be warned in advance of a change. For instance, Capital One Financial Corp., which had long stressed its low rates, on Nov. 18 began promoting a "PrimeLock" card, whose rate matches the monthly prime lending rate and rises along with it. Perhaps 60% of new card offers

are for variable-rate cards, up from half in 2002, says McBride of Bankrate.com.

That has helped. On average, variable-rate cards carry an annual interest rate of about 14.34%, up from 13.9% a year ago, according to Bankrate.com. For most consumers who carry balances, such

CONSUMER FINANCE

A NEW HEADACHE FOR THE CREDIT-CARD BIZ

First refinancing let people pay off their cards. Now they're tapping home equity

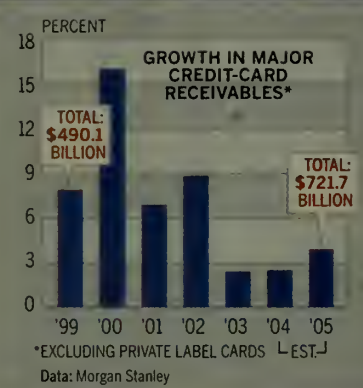
ROBERT E. STONE II IS the kind of guy credit-card companies hate. When those seductive low-rate card offers come pouring in by mail, he says, "they go right into the recycling bin." The only thing Stone, a university press marketing manager in Ann Arbor, Mich., wants to do is pay off his debt. Adding more plastic to his wallet, he says, would be "taking two steps forward and three steps back."

Unfortunately for credit-card issuers, more and more folks are finding ways to move away from plastic. For several years they've piled their debt onto their home mortgages through refinancing. And with the refi boom winding down, they're moving it to low-rate home-equity loans. The shift, along with the higher costs of funds, is dimming industry prospects. Growth in credit-card receivables—what card hold-

ers owe—has slipped to low single digits for issuers in the last couple of years, and some industry watchers think the trend is here to stay. "The logic of borrowing at 3% to 7% on a home-equity loan compared to 13% on a credit card is too powerful to ignore," says Morgan Stanley analyst Kenneth A. Posner.

That dynamic has transformed the credit industry into an ever more cutthroat arena in which maintaining profitability is increasingly tough. Fierce competition in the battle for market share has driven plastic issuers to keep churning out the zero-rate or low-rate balance-transfer offers they've come to rely on. And despite rising rates,

HOLD THE PLASTIC



small hikes add only a few dollars to the typical monthly balance—not enough to make them switch cards but enough to help bolster margins. Still, card issuers must walk a fine line, wooing some consumers with low teaser rates even as they hike rates for others.

NEW FEDERAL GUIDANCE?

INDEED, CREDIT-CARD companies are quietly putting the squeeze on customers in other ways. They're shorten-

To fight back, more cards are offering rewards

ing the periods when low teaser rates stay in force, for instance, sometimes to as little as three months.

At the same time, they're increasingly resorting to marketing gimmicks to keep cardholders from

looking for better deals. Elaborate rewards programs that offer airline miles, electronic gear, gift certificates, and even seats on the bench at NFL games are among the come-ons credit-sellers are using. MBNA Corp. offers American Express credit cards that carry the names of alumni associations or other so-called affinity groups as well as a card that lets consumers amass points used to reduce their mortgages. MBNA Senior Executive Vice-President Jim Donahue insists that his company can outgrow the industry. But he concedes the growth rate "is going to be a little bit lower" than the sharp gains of a few years ago.

The credit-card industry may get help from an unexpected quarter: Bank regulators are hinting that they won't allow the home equity binge to continue unfettered. Given the roughly \$460 billion in such loans outstanding, the Comptroller of the Currency is drawing up new guidance for national banks on managing risks in their home-equity portfolios. "We have lots of risk guidance for credit cards, but now home-equity loans are getting to the same scale," says a spokesman for the Comptroller. "We just want to make sure that banks are managing those risks as well."

Still, credit-card outfits can't just fight among themselves anymore. Now they can add home-equity lenders to the list of rivals that are finding gold in America's growing mountain of consumer debt. ■

—By Joseph Weber in Chicago with Mike McNamee in Washington

GOVERNMENT

WANTED: ONE TOUGH ECONOMIC TEAM

Bush needs new talent to carry out his ambitious second-term agenda

DESPITE FOUR SUCCESSFUL rounds of tax cutting, GOP insiders say George W. Bush has never been satisfied with his economic advisers. They have simply not been up to the task, observers say, of articulating their boss's expansive vision of a market-oriented Ownership Society. "The White House feels it has just never found the right economic team," says a GOP lobbyist with Administration ties.

Bush jettisoned his first group—a fractious band of policy wonks led by Treasury Secretary Paul H. O'Neill—in December, 2002, after he tired of O'Neill's freelancing and his aides' wrangling. The replacements, led by the boosterish John W. Snow at Treasury, have gotten along better and did a passable job of selling Bush's policies on the campaign trail. Still, insiders say the President wants an infusion of new blood and Beltway savvy, perhaps all the way to Treasury.

The challenges and the stakes are high. A new team must have the political skills to push through Congress Bush's controversial plans to reform Social Security and overhaul the tax code while coping with a stubborn budget deficit. It must have the financial market smarts to manage the dollar's decline and sell what's likely to be a debt-financed pension reform plan to skeptical bond traders. And it will need the economic knowhow to turn Bush's sketchy tax reform principles into a well-thought-out proposal that can spur growth.

With battle fatigue setting in across the Administration, the Commander-in-

Chief could use "more firepower and more pizzazz" in the economic ranks, says Gregory R. Valliere, managing director of Stanford Washington Research Group. Bush needs recruits "who can spin the story very adroitly—especially to Wall Street and Capitol Hill."

SURPRISING CHOICE

THE PRESIDENT TOOK HIS first step toward reconstituting his economic team on Nov. 29 by tapping Kellogg Co. CEO Carlos M. Gutierrez to replace longtime Bush friend Donald L. Evans as Commerce Secretary. A surprise choice, the Cuban-born Gutierrez hasn't been politically active and has never donated money to Bush. But his Hispanic heritage and his business ties could prove a political plus, especially as he labors to sell tax reform to small business and the entrepreneurial community.

What's more important, though, is who the President picks to take over two key White House posts. Ex-Wall Streeter Stephen Friedman is stepping down as head of the National Economic Council, while White House chief economist N. Gregory Mankiw is expected to resign in February to return to Harvard University. Tim Adams, a former Treasury official knowledgeable about the ways of Washington

and the financial markets, is a leading candidate to replace Friedman. Along with Office of Management & Budget Director Joshua B. Bolten, Adams would form a potent White House team that could play a key role in tax reform.

Also potentially up for grabs: the big enchilada, the Treasury Secretary's job. A Bush loyalist and hyperkinetic salesman



ON THE WAY OUT?
Treasury Chief Snow



COMMERCE BOUND Gutierrez has politically useful business ties

ernment red ink—Gramm might have a better chance of selling Social Security changes on the Hill.

Tax reform may be even harder. While there's a consensus among Republicans on the way to reform Social Security, no such accord exists on overhauling the revenue code. Some want a national sales tax. Others want a flat levy on income.

It's not only Congress that the econoids will have to sell on Bush's reform plans. It's the financial markets, too. The extra borrowing Bush may seek to fund Social Security reform could prove hard for bond investors to swallow when they're already financing record deficits. And real difficulties could lie ahead for the dollar. So far, the greenback's decline—it has fallen about 15% over the past

the stump, Snow has signaled that he wants to stay on into next year to complete tax-reform study. But an increasingly vocal band of advisers inside and outside the administration are agitating for Snow to step down sooner. To hear them tell it, Snow lacks the stature on Capitol Hill to sell the President's radical Social Security and tax plans. Indeed, his last-minute effort to clean up the pork-ridden corporate tax bill with its \$140 billion in giveaways was all but ignored by lawmakers. Internally, he has been largely overshadowed in policy debates by Bush confidant Bolton. And while the Treasury chief has not triggered any major turmoil in currency markets, his repeated assertions of a strong dollar policy have begun to ring hollow as the greenback continues to decline.

Getting a new team in place can't come

soon enough. While the President sidestepped Democratic attacks on his plan to introduce Social Security personal investment accounts, the initiative will still engender bitter opposition in Congress. A huge obstacle: making the case that benefits may have to be cut if the numbers are to add up. Also sure to raise hackles on Capitol Hill, especially among Republican budget hawks, is the plan to borrow up to \$1 trillion to finance the transition.

GRAMM BOOSTERS

THAT'S WHY SOME IN the GOP are pushing for politically well-connected former Texas Senator Phil Gramm, now vice-chairman at UBS Investment Bank, to take over for Snow. A budget hawk himself—he co-authored the 1985 Gramm-Rudman-Hollings Act, which aimed to reduce gov-

three years—has been trouble-free. But lately the drop has picked up speed, raising fears of a crash that could cripple the economy. That argues for naming a financial market pro, such as former Credit Suisse Group co-CEO John J. Mack or California financier Gerald L. Parsky, a Treasury official in the Ford Administration, to assume Snow's job and ensure that there's no crisis of confidence in the financial markets.

While the Washington rumor mill churns, the only safe bet is that Bush will surprise everyone with some bold appointments. Judging by the agenda he has carved out for his second term, he'll need every one of those new recruits—and then some—for the battles ahead. ■

—By Rich Miller, with Mike McNamee and Lee Walczak, in Washington

Bushonomics II: A Tall Order

RUNAWAY SPENDING

Facing a \$348 billion deficit for 2005, lawmakers want stricter spending restraint from the White House. The Iraq war and soaring entitlement spending could overwhelm a proposed clampdown.

TAX CUTS

The Bushies will fight to make their first-term rate cuts permanent. But the huge costs—\$1 trillion through 2014—could undermine support for the Administration's other goals, such as funding new retirement accounts.

SOCIAL SECURITY

Bush will seek an early vote to create individual accounts carved out of Social Security. Plans for creative accounting or heavy borrowing to cover the \$1 trillion-plus transition could unsettle financial markets.

TAX REFORM

Bush will name a blue-ribbon commission to craft tax-reform options by summer. Any drive to simplify the code, close loopholes, and tilt the system toward taxing consumption rather than income could trigger a huge political brawl.

GLOBAL WOES

Policymakers will need a deft touch to prevent a dollar rout that could send interest rates sharply higher. The new team will have to redouble efforts to cope with China's emerging global clout and make progress in multilateral trade talks.

COMMENTARY

BY JOHN CAREY

How to Prevent Another Vioxx

The tragedy should spur Congress and the FDA to improve the safety of new drugs

IN THE U.S. DRUG industry, it often takes a disaster to bring change. Not until thousands of European babies were deformed by thalidomide in the late 1950s and early 1960s did Congress raise standards for approvals. Now the Food & Drug Administration and Congress are grappling with what FDA whistle-blower David Graham says "may be the single

greatest drug-safety catastrophe in the history of this country"—the use by millions of people of a painkiller, Merck & Co.'s Vioxx, that raises the risk of heart attacks. "It is a shame that something bad had to happen," says Dr. Albert I. Wertheimer, director of Temple University School of Pharmacy's Center for Pharmaceutical Health Services Research, "but this is a wake-up call."

Still, that call may not be fully heeded in Washington, where the powerful pharmaceutical industry will oppose serious reforms. That would be a mistake. Congress and the Bush Administration should legislate changes long advocated by safety experts, such as better clinical trials before drug approvals and stronger oversight after drugs are on the market.

The problem is that not enough is known about the benefits and risks of new drugs. Congress made this gap more difficult to address in the early 1990s by requiring faster FDA approvals, funded by industry dollars. Before that, drugs typically hit the market first in Europe, so the FDA had a chance to learn from data collected abroad before deciding to approve a drug here. Now that approvals are swifter, there's greater need to study and monitor new drugs more closely. Key steps:

BETTER PRE-APPROVAL CLINICAL TRIALS "We have to demand more of drug companies," says Dr. John A. Hama, associate professor at Harvard Medical School and author of *Powerful Medicines: The Benefits, Risks, and Costs of Prescription Drugs*. A typical

months-long trial with 3,000 carefully selected patients is likely to spot problems that show up only with longer-term use and more patients. Merck's original Vioxx trials should have been longer, larger, and more representative of the general population.

These changes don't have to be costly. Modern statistical tools and trial designs could yield more information for a given cost, adds Dr. Raymond L. Woosley, vice-president for health sciences at the University of Arizona College of Medicine.

MORE RIGOROUS POST-APPROVAL MONITORING. There's always a balance between getting drugs to patients quickly and studying medicines long enough to learn about side effects. "Pre-approval testing 'it is very difficult to pick up infrequent effects,'" says Dr. Steven Galson, acting director of the FDA Center for Drug Evaluation & Research. That's why the FDA

must beef up its post-market oversight. The agency could make mandatory doctors' reports of cases where patients appear to be harmed. Now they're voluntary and haphazard. The FDA should also require companies to track what happens to the first 100,000 or 200,000 patients who get a new drug. And it should demand more clinical trials when problems are suspected.

The FDA approves some drugs without the condition that companies do long-term studies. But two-thirds of the time companies fail to do them. Congress should give the agency the power to levy fines big enough to give drugmakers the incentive to actively pursue needed follow-up studies.

BOOST DRUG-SAFETY EXECUTIVES' CLOUT The same FDA division that approves drugs also decides whether to take a drug off the market. But "reviewers don't like to admit they made a mistake," explains a congressional staffer. The result: It takes too long

for the FDA to add restrictions or pull drugs. The agency's Office of Drug Safety needs more resources and more power to make these key decisions.

While it ponders these steps, Congress could also consider deeper questions. Do Big Pharma's dollars for drug review make the agency too beholden to the industry? Do direct-to-consumer ads encourage people to take drugs they don't need? It's tragic that thousands of Vioxx users may have died. If their deaths should lessen the chances of similar disasters.



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COMMENTARY

BY CHRISTOPHER PALMERI

CalPERS: Getting Back to Business

The new chief should refocus on corporate governance and investor returns

IT'S ONE OF THE most powerful jobs in the world of finance. The president of the board of the California Public Employees' Retirement System oversees the nation's largest pension fund, with \$177 billion in assets. But the position has also become a bully pulpit, letting the occupant rattle everyone from underperforming CEOs to the chairman of the New York Stock Exchange.

It seems CalPERS President Sean Harrigan has rattled a few too many people for his own good. On Dec. 1, Harrigan's nearly two-year run came to an abrupt end when he was unexpectedly voted out of his board seat. His ouster has been assailed as a setback by labor union leaders and consumer activists who considered him a champion of workers and investors. Truth is, though, his departure gives the giant pension fund a much-needed chance to get back on track. Known over the past two decades as a crusader for investor rights and corporate-governance reform, CalPERS has suffered in recent years under Harrigan and his overreaching agenda. He caused a furor in California last year when CalPERS used its influence to pressure supermarkets to settle a nasty strike. And Harrigan unnecessarily angered Corporate America by withholding CalPERS' support for boards at hundreds of companies in order to push what the business community perceived as his pro-labor views.

In the wake of Harrigan's departure, CalPERS surely should not back off on the strong reputation it has earned over the years for pursuing corporate governance that is truly in the interests of shareholders. But its activism should be focused on improving management performance and accountability, not on trying to fix the ills of the world. That's why CalPERS' new president will need to get back to basics and concentrate on issues that will most clearly improve investment returns for the fund's beneficiaries, the 1.4 million current and retired government workers in California. "They need to be targeting individual companies, not issues that are too wide," says Richard H. Koppes, a longtime CalPERS gener-

The fund must target overpaid execs and insular boards—and forego politics



HARRIGAN Some observers feel his pro-labor moves were a distraction

attempt to oust Safeway Inc. Chairman and Chief Executive Officer Steven A. Burd, who, it said, had mismanaged the company.

Under Harrigan, CalPERS made other questionable moves. To protest conflicts of interest that arise when companies hire accounting firms to perform both auditing and consulting work, CalPERS withheld its votes for directors at some 2,700 companies last spring. Among the directors CalPERS chose not to support were legendary investor and Coca-Cola Co. board member Warren E. Buffett. The move angered business leaders who felt the real intention was to signal to board members that labor was willing to throw its weight around. "I don't think anyone believes there are 2,700 Enrons out there," says David Hirschmann, a senior vice-president at the U.S. Chamber of Commerce.

CalPERS' 13-member board, a mixture of political appointees, state office holders, and representatives chosen by CalPERS beneficiaries, will elect a new president in February. Harrigan said in a statement that he believes CalPERS will continue to be a strong champion for shareholders' rights.

Let's hope so. CalPERS needs to continue challenging overpaid and underperforming corporate execs. The fund should also push for changes in proxy rules to allow shareholders to nominate their own board candidates. What it must avoid is too many overtly political battles that likely cost Harrigan his job. ■

—With Sarah Lacy in San Francisco

al counsel now in private practice. "They became too political."

To say Harrigan was a controversial leader would be an understatement. A longtime executive at the United Food & Commercial Workers Union, Harrigan was appointed by then-Governor Gray Davis, a Democrat, to California's State Personnel Board in 1999. That board, which oversees issues regarding state employees, later chose him as its representative at CalPERS, whose board elected him as its president in February 2003. In addition to leaning on California supermarkets to end a strike last year, CalPERS later led an unsuccessful attempt to oust Safeway Inc. Chairman and Chief Executive Officer Steven A. Burd, who, it said, had mismanaged the company.

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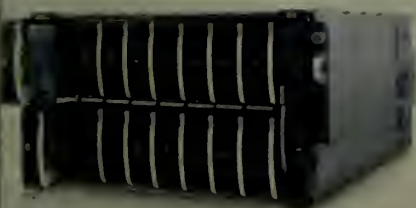
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—With Sarah Lacy in San Francisco



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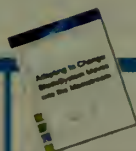
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THE ECONOMY

JUST HOW CHEAP IS CHINESE LABOR?

Reliable data don't exist, but the U.S. government is doing some sleuthing

EVERY YEAR THE U.S. BUREAU of Labor Statistics compares manufacturing labor costs in the U.S. with those of about 30 global rivals. Its latest report, on Nov. 18, showed that average hourly compensation of foreign factory workers rose 12% in 2003, measured in dollars, compared with 4% in the U.S.

But these statistics have a glaring omission: China. The BLS can't compare Chinese and U.S. factory labor costs because reliable statistics from the Asian giant don't exist. That makes it hard to assess China's competitive strength.

Now, the info deficit is starting to be remedied. This past summer, the BLS hired a Beijing-based American consultant, Judith Banister, to dig through China's mountain of incomplete and sometimes unreliable statistics. The goal: to calculate average manufacturing compensation in China in 2002—the last year for which data was available. *BusinessWeek* was given a preview of her findings, which she will present to the BLS later this month.

Her estimate? The cost of Chinese factory labor is a paltry 64¢ an hour. Although that figure is rough, since it's pieced together from sketchy statistics, it's still the most thorough estimate ever compiled. It includes both wages and employer contributions for benefits and social insurance. And it covers not just city factory workers, who get the most attention, but the more numerous rural and suburban factory workers as well. For comparison, hourly factory compensation in the U.S. in 2002 was \$21.11, and an average of \$14.22 in the 30 foreign countries covered by the existing BLS report.

How Banister came up with her estimate is a tale of patient data sleuthing. Since the BLS wanted to be able to replicate her numbers in the future, she relied solely on official, public data. So the Stan-

LURE Western firms locate in cities, where compensation is \$1.06 an hour
 ford University educated demographer and former Census Bureau staffer starts

with China's *Labor Statistical Yearbook*. But it covers only 30 million factory workers, all in cities. And it covers wages only, not benefits and social insurance. To fill in the blanks, she had to unearth such hard-to-find data as Agriculture Ministry stats on rural factories. She and an assistant found crucial figures on social insurance contributions only by doggedly scanning hundreds of volumes in the bookstore of the Labor Social Security Ministry.

WESTERN RATES

BANISTER CONCLUDED China has about 38 million city manufacturing workers. The 30 million on whom she found data earn an average \$1.06 an hour. Another roughly 71 million suburban and rural manufacturing workers earn an average 45¢ an hour, for a blended 64¢. In the current BLS survey, Mexico's \$2.48 hourly compensation is the lowest.

Because China's living costs are low, that 64¢ buys as much as \$2.96 in the U.S. Banister estimates inflation-adjusted pay in cities doubled from 1990 to 2000. (She thinks it rose outside cities, too, but won't guess how much.) She figures that between 1995 and 2002, factory jobs fell by at least 11 million in cities as state-owned enterprises shed workers, and rose some 5 million outside cities.

Western companies shouldn't walk into China expecting to pay 64¢ an hour. They usually locate in cities, where wages are higher, and hire skilled workers who

earn more, says R. Mark Mechem, an adviser at the U.S.-China Business Council. Plus, Banister's figure for 2002 misses recent pay hikes. The BLS plans to scrutinize Banister's results over the next year. Before it includes China in its survey, the Chinese need to improve their counting. The Labor Ministry has begun a trial workforce survey based on random sampling and may soon release results. Meanwhile, the BLS project is a start. Getting grip on China's labor costs is vital. You can't run a modern economy without good data. ■

—By Peter Coy in New York

Pay Gap

Average hourly compensation for factory workers*

U.S.

\$21.11

CHINA

\$0.64**

* 2002 data for U.S. production workers; China all manufacturing workers. ** Estimate.
 Data: Bureau of Labor Statistics; Judith Banister, consultant to the BLS.

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COMMENTARY

BY DIANE BRADY

Quit While You're Ahead, Hank

Investors are fretting about the lack of a definitive succession plan at AIG

MAURICE R. "HANK" Greenberg has had a stellar run at American International Group Inc. In his 37 years at the helm, the 79-year-old insurance titan has built aig into a \$81 billion powerhouse. And his tenure has withstood turbulence. Even with this year's flurry of hurricanes, net income at the New York insurer grew 22.3% in the first nine months, to \$8.03 billion.

But the winds of change aren't blowing hard enough through the halls of AIG itself. Investors are unhappy with the investigations that have buffeted the company in recent months—not to mention a lackluster stock price. While no institutional investor is yet calling publicly for Greenberg to step down, it is clearly time for AIG and its board to get serious about setting a time frame for succession. Says one major institutional investor: "A straightforward plan for Hank's retirement might clear the air."

And with the probes appearing to veer closer to Greenberg, the sooner the better, some investors say. A recent report in *The Wall Street Journal* alleging that federal prosecutors are investigating the AIG chief for possible securities violations has heightened concerns on Wall Street, although an AIG spokesman says the U.S. Attorney for the Southern District of New York has not yet been in touch with the chairman and CEO. The new questions follow a spate of probes by the Securities & Exchange Commission, Justice Dept., and New York Attorney General's office that have some investors worried about broader problems. Even the announcement on Nov. 30 that AIG had struck a \$126 million settlement

with the SEC and Justice Dept. over a series of controversial transactions has failed to put to rest the growing qualms. AIG did not admit or deny any wrongdoing under the settlement.

While none of the allegations yet warrant a shakeup, the lagging stock is making investors restless. True, they were perfect willing to overlook Greenberg's autocratic management while the share price was rising. But not anymore. In recent years AIG stock has badly underperformed the industry. Total returns have dropped 35% since late 2000, when the stock peaked 100. That's double the drop of the S&P 500 Insurance Index.

The disappointing performance is prompting some shareholders to take a second look at the house that Hank built. One issue is how Greenberg's long-lasting hold on the top job has undermined the talent pool at the company. Over the years, scores of star managers have left AIG, say executive recruiters. The issue

wasn't just being denied a shot at the top job; it was also the Hank-centric culture that gave them little room to shine. AIG has recognized this and taken some small steps to give other execs a more public profile. But the risk remains: Investors might have little confidence in the new management when Greenberg finally does retire.

Moreover, some believe that the culture Greenberg has created needs a shakeup. Not only did some regulators cite a lack of cooperation, bordering on arrogance, in their investigations, but

practices such as AIG's byzantine compensation structure hold little place in this age of improved governance.

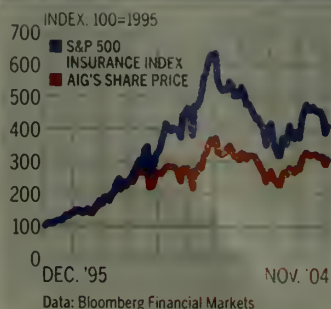
That's why it's time for AIG's board to start identifying and grooming likely candidates. Yes, Greenberg in 2002 established a stable of more visible contenders by bringing execs into the newly created office of the chairman. But he has since deflected retirement questions—other than to say that he's fit and eager to continue and that he has drafted a secret letter stating who he thinks should succeed him. That will go to the board upon his departure. At least two men have a good shot: Martin J. Sullivan, 50, and Donald P. Kanak, 51, both of whom have extensive international experience and hold the joint titles of vice chairman and co-chief operating officer. AIG says independent directors will pick a successor. But neither the board nor the contenders have any idea when that might be.

Greenberg may be overestimating his staying power. Successors, says University of Michigan Ross School of Business professor Noel Tichy, are "usually not the best judge of when it's time to leave." Much of Greenberg's record remains impressive. All the better, then, to leave with his legacy intact. ■



GREENBERG At 79, the insurance titan shows no sign of stepping down

THE GREENBERG RECORD



EDITED BY ERIC SCHINE

HEADLINER JIM JENNESS



FEELING HIS OATS

After more than 25 years in advertising, James Jenness joined Kellogg's board in mid-2000. Now he's the surprise successor to Kellogg chairman and CEO Carlos Gutierrez, who revived the lumbering cereal giant. But some wonder if outsider Jenness can keep Kellogg afloat.

When President George W. Bush nominated Gutierrez on Nov. 29 as his next Commerce Secretary, many assumed Kellogg's board would promote President and Chief Operating Officer David Mackay. While Mackay, 49, was named to the board, directors tapped Jenness, 58, concluding Mackay needed more grooming.

A former vice-chairman and COO at Kellogg's ad agency, Leo Burnett, Jenness knows the company's brands. That should help: Gutierrez' turnaround of the Battle Creek (Mich.) outfit was based largely on pumped-up marketing.

Jenness, a marathon runner, says he's in his new job "for the long haul." To prove his skeptics wrong, he'll need to be a fast starter, too.

—Michael Arndt

TORRENTS OF ARABIA

Surprised by the strength of global economic growth this year, Saudi Arabia, the world's leading oil exporter, and OPEC are boosting capacity. Earlier this year Saudi capacity may have been as low as 9.5 million barrels per day, according to a recent study by Edinburgh-based energy consultants Wood Mackenzie. Saudi Aramco is working to bring two large projects onstream that would produce up to 800,000 bbl per day by yearend. Capacity could reach 11 million bbl per day by the end of 2005. Wood Mackenzie estimates that OPEC will have added about 1.5 million bbl per day in capacity by yearend. That helped allay fears of a supply disruption, as oil futures fell to \$46 per barrel on Dec. 1.

PFIZER THE FEARLESS



Drug giant Pfizer is vowing it will succeed where others have failed. On Nov. 30, the drugmaker held its annual analyst briefing and warned that between 2005 and 2007, Pfizer drugs with sales of \$14 billion could lose patent protection, exposing them to generic competition. But while such losses have severely hurt competitors such as Merck and Bristol-Myers Squibb, Chairman and

Chief Executive Henry McKinnell Jr. vowed Pfizer's R&D strength would allow it to prosper in the face of the generic hits. Not everyone on the Street is buying McKinnell's upbeat assessment. Sanford Bernstein analyst Richard Evans expects Pfizer sales to be down slightly between '05 and '07 while earnings, he projects, will be up only marginally.

RAYTHEON'S GOP DIVIDEND

Buoyed by a record \$30 billion backlog of defense contracts, on Dec. 1 Raytheon announced that it would boost its dividend 10% next year, and spend up to \$700 million to buy back its shares over the next two years. Like other defense contractors, Raytheon figures it will benefit from the Republican sweep in the Nov. 2 election. Its shares are up 36% year to date, and the company now projects the defense budget will grow at a 5% compound annual clip through 2009.

SONY: BURNED IN DVDs?

Is it Betamax all over again for Sony? The Japanese electronics giant, eager to capture the next generation of high-definition DVDs, has been beaten to the punch by a rival technology being pushed by Toshiba and computer maker NEC. Hollywood studios Paramount, Universal, and Warner Bros., whose content is considered crucial to promote the new technology, signed nonexclusive agreements to put out films next Christmas on Toshiba's HD-DVD format. Sony, whose Betamax lost out to the Toshiba-backed VHS format in the 1980s, has lined up its

Sony film studio and MGM behind its Blu-ray DVDs, which have more interactive capacity but are more expensive to produce. By next year the market for the new high-definition DVDs could grow rapidly, as up to 20 million U.S. homes could have HDTV sets, according to Kagan World Media.

ET CETERA...

► General Motors said sales fell 16% in November, while Ford sales dropped 7%.

► ESPN announced a deal with Sprint to launch its own brand of mobile phone service in 2005.

► H.J. Heinz may repatriate \$1 billion in foreign profits at reduced tax rates.

CLOSING BELL

Shares of Humana jumped nearly 8%, to \$26.76, on Dec. 1 after the Louisville-based health insurer raised its profit outlook for 2004. Strength in its Medicare business is helping to propel growth. Humana also said it expects profits to grow a brisk 12% to 15% in 2005.



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Want to see how
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your
CONTACT CENTER?
Just ask Pebble Beach Company.



EDITED BY MIKE McNAMEE

Telecom Taxes: Is A Breakthrough Near?

THE BATTLE OVER WHETHER states can tax new technologies, the nation's governors won a skirmish in November. While Congress agreed to temporarily restore a ban on state taxes on monthly Internet access charges, anti-tax lawmakers failed to bar state levies on Internet phone calls—known as Voice-over Internet

protocol (VoIP). The issue is critical because VoIP promises to dominate the phone business within the next decade.

Now the states are going on the offensive. *BusinessWeek* has learned that two new initiatives may set the stage for dramatic changes in the way all telecom services are taxed. For consumers, that may mean an end to the stew of mind-numbing charges levied by state and local governments. But it may also mean that VoIP, now tax-free in most locales, will be hit by the same taxes as traditional phone service. At stake: \$20 billion a year in taxes.

To protect that revenue, the National Governors Assn. has asked officials representing states, cities, and counties to meet with top telecom officials in Washington on Dec. 15 to begin talks aimed at resolving the tax issue. The goal: Simplify taxes while taxing all phone services equally—no matter what technology delivers them. "It's important that we work through this in a cooperative fashion," says Virginia's Democratic governor, Mark Warner, president of the NGA.

At the same time, local officials and industry reps in Virginia are close to a deal that could be a model for a national solution. Today, Internet-based calls are tax-free in Virginia, but calls connected by old-fashioned switches are subject to nearly \$400 million in taxes and fees. The Virginia agreement would replace those levies with a flat 5% tax on all telecom services—including VoIP. Negotiators hope to bring the plan to the state legislature in January. Our goal is to treat VoIP like other voice technologies," says Michael L. Edwards,

deputy director of the Virginia Municipal League. The deal, adds Rick Cornwell, Verizon Inc.'s director of government affairs, is "our attempt to put everyone on the same level of taxation."

Unhappy Bells

EVEN IF VIRGINIA provides a blueprint, a national agreement will be a stretch. In most states, telephone taxes are set by local governments. And they are wary of letting states collect the levy, even if governors promise to return the revenue. For its part, the telecom industry is also split. The companies all want tax cuts. But a donnybrook is brewing between those that offer the new

services, such as AT&T and Vonage, and those that need to protect their old technology. Says one lobbyist: "The Baby Bells are stuck under regulatory and tax rules that the VoIP outfits don't deal with. And they want a level playing field."

The talks will take place under growing pressure from Congress. GOP tax cutters will try again to ban

state and local VoIP taxes next year. And incoming Senate Commerce Committee Chairman Ted Stevens (R-Alaska) may soon push a broad rewrite of U.S. telecommunications

law—could toss the tax dispute into a massive political whirlwind.

So state and local officials are moving quickly. They know they have a narrow window to get ahead of the technology, tax all telecom services equally, and protect badly needed revenue. Perhaps consumers will even get a comprehensible phone bill in the process. ■

—By Howard Gleckman,
with Catherine Yang



REVENUE AT RISK
Warner has asked all the players to meet in D.C.

CAPITAL WRAPUP

THE SEC GETS SOME STATIC

THE EASY DAYS of pushing new rules on a scandal-weakened Wall Street are ending for the Securities & Exchange Commission. **Phillip Goldstein**, who runs hedge fund Opportunity Partners, has teed up a lawsuit to overturn a new SEC requirement that hedge-fund managers must register with the agency, charging that the SEC lacks explicit authority from Congress to oversee those private investment pools. SEC officials believe the agency is on firm legal ground. The suit is coming as the Street's protests are forcing the SEC to postpone its controversial plans to speed up electronic trading on the New York Stock Exchange. Rather than call a scheduled vote on Dec. 15, SEC Chairman **William H. Donaldson** now plans to send the proposal back out for more comment—giving the Big Board's floor brokers and other opponents another chance to soften the plan.

STILL AT IT IN IRAQ: "EXTREME AUDITORS"

CONTRACTORS IN IRAQ aren't off the hook yet. An overlooked amendment in the recent defense authorization bill extends the life of the Coalition Provisional Authority's Inspector General's Office, originally scheduled to expire on Dec. 28, into late 2006. After losing nearly half its employees, the IG unit is hiring again.

The office made headlines in late November when it recommended withholding payments owed to Halliburton Co. With more than two dozen flak-jacketed workers doing what they call "extreme auditing" in Iraq, more critical contracting reports are likely. So are "lessons learned" studies that could slam the Bush team.

CURRENCY MARKETS

THE MAKINGS OF A MELTDOWN

Why the danger of a stampede away from the dollar remains

IF INVESTORS NEEDED A WAKE-UP call about how heavily the global financial system relies on the actions of Asia's central banks, they received a nasty one on Nov. 26. A widely reported remark by People's Bank of China Policy Board member Yu Yongding that Beijing planned to trim its purchase of U.S. Treasuries quickly sent the dollar to four-year lows vs. the euro and the yen. The markets, spooked just a week earlier by statements from Federal Reserve Chairman Alan Greenspan, were filled with speculation that the day of financial reckoning was coming for America and its soaring trade and government budget deficits. If China were to start dumping U.S. assets, the theory goes, other Asian central banks would likely follow to protect the value of their foreign reserves from a dollar crash.

FALSE ALARM

IT LOOKS LIKE a false alarm. Beijing quickly moved to quell the fears by declaring that Yu had been misquoted. Soon after, Chinese Prime Minister Wen Jiabao repeated for the umpteenth time that Beijing will not change any time soon its policy of pegging its currency, the yuan, at 8.3 to the dollar. That means China would have to keep adding dollars to its \$515 billion in foreign reserves, which this year have been growing at about \$15 billion per month, in order to offset inflows from foreign investment and export earnings. While the dollar continued drifting to 102 yen and the euro hit \$1.33, many analysts argue that it may be poised for a technical rebound as Japan, South Korea, and other nations intervene in the markets again to halt



sharp appreciation of their currencies.

Still, those days of jittery trading have exposed a raw nerve that is likely to run through the world financial system through 2005. How much longer, asks a growing chorus of economists, will the U.S. continue to rely on Asian central banks to finance its skyrocketing current account deficits? China, Japan,

and other Asian nations already have amassed \$2.2 trillion in foreign reserves, much of them recycled into U.S. Treasuries. Meanwhile, the U.S. current-account deficit, expected to reach \$665 billion this year, or a record 5.7% of gross domestic product, would hit 6.3% of GDP in 2005 and 7% in 2006, based on current oil prices and import and export trends. And given its low domestic savings rate, the U.S. will likely have to step up its offshore borrowing to finance the gap. As a result, traders sense the approach of a mega-realignment of the dollar vs. global currencies.

HIGH EXERCISE

LOOK CLOSELY AT U.S. data, however, and fears of an Asian dollar stampede look overblown. They show that Asian central banks, with the exception of Japan, already have been weaning themselves off dollar assets for the better part of the year—without triggering a spike in inflation or U.S. rates. Taiwan and South Korea have increased their dollar holdings only modestly, those of Thailand and Singapore have stayed virtually flat, and Hong Kong's Treasury holdings have dropped by \$5 billion. As a result, the Singapore dollar is up 4% this year against the greenback while the Korean won has slipped 14%. "Everybody has been scaling back, and the whole exercise has been pretty benign," says emerging-market strategist Chen Zhao of Montreal-based BCA Research.

China has been quietly diversifying its holdings as well. Even though its foreign reserves have swelled by \$100 billion over its year's first nine months, China has purchased only \$17 billion worth of Treasuries and other U.S. bonds, BCA estimates. This is way behind the pace of 2003, when China bought \$60 billion in U.S. bonds. Even though China still needs to buy Treasuries to offset investment inflows, that need is less urgent than before. In recent months, analysts say, China's repeated insistence that it will not change its currency peg soon ap-

How much longer can the U.S. rely on Asia to fund its twin deficits?

parently has helped stem the China-bound surge of speculative money. That means Beijing doesn't have to buy up as many dollars.

So where has Beijing been parking some of its mounting reserves? Some 20% are now in euros, estimates UBS Securities Asia economist Jonathan Anderson, while China also has put more in yen and

pounds. "China has already diversified away from U.S. dollars," says Zhao Xijun, vice-director of the Finance & Securities Institute of Beijing's People's University. The shift has helped put upward pressure on the euro, which the Europeans are understandably concerned about: Europe has unfairly borne the brunt of the world's currency dislocations. But the Chinese move to diversify has created just a ripple in the \$4 trillion U.S. Treasury market.

There are other reasons Asian central banks will probably not lead a panicky charge out of dollars. For one, Asia's economies still depend heavily on exports to the U.S. for growth and jobs. If Asian central banks stop buying dollars and send U.S. interest rates soaring, they will tank their biggest and most strategic market. "It's probable that over time central banks will want to reduce their exposure to a single currency like the dollar," says Nick Bennenbroek, senior currency strategist at Brown Brothers Harriman & Co. "But there's not much risk this will happen anytime soon."

In fact, some Asian central banks could start jumping back into Treasuries. After boosting its holdings in U.S. bonds by 46%, to \$721 billion, in this year's first eight months, Japan has since stayed on the sidelines. As a result, the yen has risen by 6.8% in six months against the dollar. But Japanese Vice-Finance Minister Koichi Hosokawa has signaled that Tokyo will aggressively hold the line if the yen nears 100 vs. the dollar. South Korea already has begun to intervene again after the won hit a seven-year high.

This does not mean the scary dollar meltdown scenario will disappear. As Asian governments stepped back, hedge funds dramatically boosted their holdings of U.S. Treasuries this year. They're a far more footloose bunch than central bankers. That's why Yu's comments triggered such angst among those who see the makings of a dollar meltdown.

And as America's twin deficits continue to breach uncharted territory, "the chances of a hard landing for the dollar increase," says economist Nouriel Roubini of New York University's Stern School of Business. As Washington's borrowing needs rise, it may have to sharply raise bond rates to lure buyers. The risk also remains that some central banks with smaller U.S. holdings, such as Russia or India, would instigate a sell-off by deciding to dump U.S. assets if they sense that the dollar is ready for another big slide.

Roubini also notes that the longer China maintains its rigid peg to the ever-dropping dollar, the more its currency will have to rise when it does decide to break the link. A dramatic revaluation would immediately affect the value of dollar-denominated assets. A 20% appreciation of the yuan, for example, would mean a \$100 billion loss in the value of China's reserves—equal to about 8% of GDP.

The U.S. and Asia can mitigate this risk by moving aggressively to correct the imbalances. The Bush Administration must devise a credible plan to narrow its yawning fiscal deficit and boost savings. Asian governments could start cutting their addiction to cheap currencies.

"If the U.S. is ever going to reduce its trade deficit, somebody [in Asia] has to reduce their exports and increase domestic demand," notes Akio Mikuni, founder of credit rating agency Mikuni & Co.

The remedies are obvious—but difficult. Don't expect Asian banks to instigate a dollar crash soon by bolting, but don't expect a risk-free correction in the financial system either. A real fix will take years. ■

—By Brian Bremner in Tokyo and Pete Engardio in New York

Asia's U.S. Treasuries Hoard

Holdings of U.S. Treasury securities by country, as of September, 2004

	BILLIONS
Japan	\$720.4
China	174.4
South Korea	66.6
Taiwan	57.4
Hong Kong	49.5
Singapore	24.1
Thailand	13.7
India	12.6

Data: U.S. Treasury/Federal Reserve

COMMENTARY

BY JASON BUSH

Ukraine: Putin's Biggest Blunder

His meddling in the country's election could cost him dearly at home

IS RUSSIAN PRESIDENT Vladimir V. Putin losing his touch? Once admired for his steely efficiency, Putin suddenly doesn't seem to be able to get anything right. He has managed to alienate Russian Big Business and many foreign investors by destroying oil company Yukos. September's terrorist attack on Beslan left him looking weak and ineffective and exposed the disorderly

state of Russia's security forces. His bureaucratic reforms have led to administrative chaos, while cuts in the social benefit system have sparked the biggest public protests in years. But when historians come to write the history of Putin's presidency, they may well conclude his biggest mistake was his Ukraine policy.

Putin clearly imagined he was promoting the winner when he interfered so heavily in Ukraine's presidential election in favor of Viktor Yanukovich, the candidate backed by outgoing Ukrainian President Leonid Kuchma. Yet the millions of protestors on the streets of Kiev and other Ukrainian cities, and the collapse of the government's authority, have made it impossible for the Nov. 21 election result—which had Yanukovich winning by 49.46% to 46.61%—to stand. If there is a fair re-election, the candidate demonized by Russia, pro-Western opposition leader Viktor Yushchenko, will almost certainly win, just as he would have won the Nov. 21 runoff but for massive ballot-stuffing documented by international observers. There's a risk that pro-Yanukovich regions in eastern Ukraine will refuse to accept Yushchenko as President, in which case Ukraine could split apart.

Either alternative will represent a massive blow to Putin's authority and prestige. A divided Ukraine would lead to instability in a region where Russia has key interests—80% of the gas Russia exports to Europe goes through Ukraine—and would be a point of tension with the West. If the country stays united, as seems likely, Putin's goal of linking Russia, Ukraine, and Be-

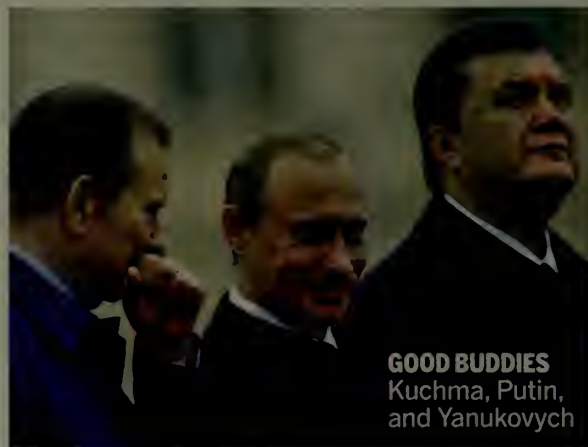
larus in a new economic union dominated by Russia looks like a pipe dream. A Yushchenko government isn't likely to be good friends with Russia after Putin's blatant meddling in the election. And if Kuchma and Yanukovich figure out how to retain power, a deeply unpopular Kiev regime would hardly be a stable partner for Russia. Another risk for Putin is that Ukrainians could inspire democratic opposition movements in other former Soviet republics. "Putin has put himself into a corner. Now no outcome looks good for Russia," says Nikolai Petrov, scholar-in-residence at Carnegie Moscow Center.

The irony is that Russia could have lived with a victory for Yushchenko. Although Moscow painted him as a rabid nationalist and Yanukovich as a loyal ally, the reality was less dramatic. As Prime Minister in 1999-2001, Yushchenko signed important

deals with Moscow and welcomed Russian investments. Yanukovich, in contrast, shut out Russian businesses and supported Washington by sending troops to Iraq.

The sensible thing for Putin to do is to tell Kiev that it can't rely on Russian backing, and work with the West to ensure a fair election. That might cost him some short-term credibility but pay off in the long run.

There's another reason for Putin to change tack. The more he interferes to stick to his guns, the more he could damage himself at home. He's already, despite government control



GOOD BUDDIES
Kuchma, Putin,
and Yanukovich

"Now no outcome looks good for Russia," says one scholar

of the broadcast media, some Russian TV channels have reported the defection of Ukrainian journalists who quit en masse rather than put out pro-Russian propaganda—a veiled attack on Putin's own repression of independent media. And if Russia keeps blaming the West for the Ukrainian mess, Russian nationalists, as well as the public, will eventually ask how their trusted President allowed Russia to be so humiliated.

A Russian revolution seems unlikely given the Kremlin's nearly total control over the political system and Putin's 69% approval rating. Events in Ukraine, though, are sure to have a powerful influence on Russia. Putin is set to retire in 2008. Like Boris Yeltsin before him, he will no doubt seek a loyal successor who will be marketed to the public using the government's massive propaganda sources. But as Ukraine's revolution has shown, it never pays to count on foregone conclusions. ■

—With Roman Olearchyk in Kiev

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ITALY

'FIAT IS IN DEEP, DEEP TROUBLE'

The company may try to force GM to buy its money-losing auto unit—or kick in cash

WHEN GENERAL Motors Corp. Chief Executive G. Richard "Rick" Wagoner Jr. and Fiat group CEO Sergio Marchionne sit

down on Dec. 14 to dine after meeting at GM's regional headquarters in Zurich, the question of industrial marriage or divorce will hang in the air. Marchionne insists he still may wield the disputed put option inked by Wagoner and late Fiat Chairman Gianni Agnelli in 2000, a put that would force GM to buy out the loss-making Italian auto maker.

General Motors argues that a subsequent recapitalization and asset sell-off at Fiat have invalidated the put. Now the one-year legal truce agreed to by GM and Fiat to find a solution has just lapsed. That means Marchionne could seek to force a union as of Jan. 24, 2005. "He is considering all options," says one Milan investment banker close to the company.

A forced purchase of Fiat Auto is the nightmare scenario for GM. Four years ago, GM and Fiat had just inked a joint venture, and the companies had acquired stakes in each other. As part of the agreement, Fiat group—which has other busi-

nesses besides cars—got the right to ask GM in the future to buy out the rest of the \$27 billion Italian auto company. Agnelli saw the put as insurance in case he could not turn around the business. GM, eyeing Fiat's 30% share in Italy, conceded to the put to make sure neither Daimler-Chrysler nor Ford could snap up Fiat.



GM blundered big-time. Stubbornly high losses and annual negative cash flow of \$1.3 billion have raised doubts about the chances of fixing Fiat Auto. Fiat group, the holding company, will record losses of \$1.5 billion this year and will probably need to raise \$1.3 billion next year to pay off maturing bonds. "I wouldn't rule

out a liquidity crisis in 2005," says Michael Raab, auto analyst at Sal. Oppenheim in Frankfurt.

If Marchionne did force GM to honor the put, it's not clear what he would get. Some say the price would be negligible, but that GM would still be stuck with Fiat Auto's \$5.3 billion in debt. Others say that Marchionne could reap \$4 billion or more if

he gets Fiat to break even in a year or more. In either scenario, GM, facing pension liabilities in the U.S. and huge losses in Europe, cannot afford an Italian car company. GM executives say privately that they are willing to tie Fiat up in court for years to avoid the put. "We have good lawyers," says one insider. But a long, nasty court battle could disrupt the joint ventures that have saved both companies billions in purchasing and development costs.

THE BAILOUT OPTION

IS THERE A WAY OUT? One possibility says those close to Fiat, is that Marchionne persuades Wagoner to inject cash into Fiat in exchange for cancelling the put. That might pave the way for the Italian state-owned holding company to participate in a capital increase in 2005. One estimate of the cost to GM would be between \$600 million and \$1.2 billion. A possible glitch: Sources close to GM say that though it may be willing to provide cash, it does not want part of any deal that increases its equity exposure to Fiat.

Whatever form it takes, a final cash injection by GM would avoid a protracted legal battle and so keep relations friendly between the two collaborators. Aside from the 10% stake GM holds in Fiat, several new models have been designed on joint platforms, including Fiat's important Punto compact, due out in September. The new GM Opel Corsa will follow on the same platform later.

A final cash injection would also give GM the opportunity to recoup some of

losses from its Fiat foray—if Marchionne achieves a turnaround specialist, achieves a miracle. Marchionne has been stalwart CEO at Fiat Auto in Herbert J. Demel, a former Audi chairman. And there are a few positive signs. Fiat Panda mini is beating expectation. And the new Punto could breathe more life into sales and help Fiat hit breakeven. But for Marchionne has to have that dinner

with Wagoner—and press a deal on a rescuer who wants out of the rescue business.

—By Gail Edmondson in Frankfurt, with David Welch in Detroit



TURIN HQ CEO Marchionne has been hiring top auto industry talent



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MEXICO

PEMEX: FROM GUSHER TO BLACK HOLE?

The oil giant's state payments have put it in debt, so a price drop could spark a crisis

WORLD OIL PRICES are at near-record highs, and Mexico is pumping more crude than ever before. The country is the world's seventh-largest oil producer and one of the top three suppliers to the U.S. Yet state oil monopoly Petróleos Mexicanos (Pemex) is hardly thriving. Indeed, in recent years the company has only been able to make ends meet through massive borrowing, so that it now owes a staggering \$42.5 billion, including \$24 billion in off-balance-sheet debt. Why? Because Pemex is the Mexican government's cash cow. The state-run company pays over 60% of its revenues in taxes and royalties, and those funds pay a third of the federal government's budget. If oil prices drop, that could spell big trouble for Pemex—and Mexico's finances.

International rating agencies are worried. They don't see a chance of default, since Pemex' investment-grade debt is implicitly guaranteed by the government. But Pemex' debt could begin to hamper its ac-

cess to international capital markets unless the government finds other sources of tax revenue. Fitch Ratings said in a Nov. 24 report that it is "concerned about Pemex' significant debt level and its ability to reduce borrowing absent material fiscal reform." Government and Pemex officials were unavailable for comment.

The key question is what will happen if oil prices head south next year, as expected. After all, Mexico's foreign-debt crisis in the '80s was sparked, in part, by a drop in crude prices. And Pemex' total debt load is four times that of Exxon Mobil Corp.'s—a company many times its size. To compound the problem, output from the Cantarell oil field, which supplies 62% of Mexico's total production of 3.4 million barrels a day, is peaking. "If we continue accumulating debt and crip-

DRYING UP The Cantarell field will go into decline next year

pling Pemex' ability to function, we're looking at time bomb that could have serious

financial consequences in less than two years," warns Francisco Rojas, a congressman who ran Pemex from 1987 to 1994.

Because of its heavy tax burden, Pemex has lost money for the past five years. It registered a \$3.6 billion loss on sales of \$55.9 billion in 2003. To ramp up investment in exploration, Pemex has been raising money through bond offerings, plus off-balance-sheet project financing schemes known as *pidiregas*. In the past five years, Pemex has taken on some \$10 billion in *pidiregas*, which are often financing packages from contractors that must be paid back when projects are completed.

THWARTED BY CONGRESS

TALK OF PRIVATIZING Pemex remains a taboo in Mexico. So President Vicente Fox has focused on improving the way the oil monopoly is run. But the opposition-dominated Congress has foiled him every turn. Raúl Muñoz Leos, the former DuPont executive Fox appointed to run Pemex, quit on Nov. 1 after less than four years on the job. And last month the senate quashed a bill that would have reduced the royalties Pemex must pay to the government on future oil finds.

Mexico will reap \$22 billion in revenue from oil exports this year—a 24% increase over 2003. Yet in a Nov. 22 report, Fitch said Mexico has used its oil bounty less productively than Russia, which is running a fiscal surplus and paying down debt. That's a huge wasted opportunity. If Mexico doesn't open its oil industry to private

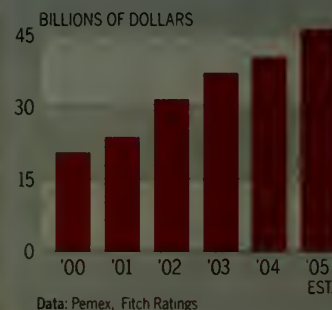
investment, the government will have to invest as much as \$10 billion in the coming decade to maintain production at current levels. "There's no way Mexico can tap its oil reserves with public money—the government doesn't have enough resources, and it never will," says Luis Téllez, a former Energy Minister who now heads the Mexico office of Carlyle Group,

Washington private-equity outfit. If the price of oil does drop, along with Mexican production, the country's nearsighted politicians will have a lot to answer for.

—By Geri Smith in Mexico City

A MOUNTAIN OF DEBT

Pemex' debt has been rising steadily



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(Average effect depending on dose. 52% at the usual starting dose.)

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Important information: VYTORIN is a prescription tablet and isn't right for everyone, including women who are nursing or pregnant or who may become pregnant, and anyone with liver problems. Unexplained muscle pain or weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. VYTORIN may interact with other medicines or certain foods, increasing your risk of getting this serious side effect. So, tell your doctor about any other medications you are taking.

To learn more, call
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Patient Information about VYTORIN (VI-tor-in)

Generic name: ezetimibe/simvastatin tablets

Read this information carefully before you start taking VYTORIN. Review this information each time you refill your prescription for VYTORIN as there may be new information. This information does not take the place of talking with your doctor about your medical condition or your treatment. If you have any questions about VYTORIN, ask your doctor. Only your doctor can determine if VYTORIN is right for you.

What is VYTORIN?

VYTORIN is a medicine used to lower levels of total cholesterol, LDL (bad) cholesterol, and fatty substances called triglycerides in the blood. In addition, VYTORIN raises levels of HDL (good) cholesterol. It is used for patients who cannot control their cholesterol levels by diet alone. You should stay on a cholesterol-lowering diet while taking this medicine.

VYTORIN works to reduce your cholesterol in two ways. It reduces the cholesterol absorbed in your digestive tract, as well as the cholesterol your body makes by itself. VYTORIN does not help you lose weight.

Who should not take VYTORIN?

Do not take VYTORIN:

- If you are allergic to ezetimibe or simvastatin, the active ingredients in VYTORIN, or to the inactive ingredients. For a list of inactive ingredients, see the "Inactive ingredients" section at the end of this information sheet.
- If you have active liver disease or repeated blood tests indicating possible liver problems.
- If you are pregnant, or think you may be pregnant, or planning to become pregnant or breast-feeding.

VYTORIN is not recommended for use in children under 10 years of age.

What should I tell my doctor before and while taking VYTORIN?

Tell your doctor right away if you experience unexplained muscle pain, tenderness, or weakness. This is because on rare occasions, muscle problems can be serious, including muscle breakdown resulting in kidney damage.

The risk of muscle breakdown is greater at higher doses of VYTORIN.

The risk of muscle breakdown is greater in patients with kidney problems.

Taking VYTORIN with certain substances can increase the risk of muscle problems. It is particularly important to tell your doctor if you are taking any of the following:

- cyclosporine

- antifungal agents (such as itraconazole or ketoconazole)
- fibric acid derivatives (such as gemfibrozil, bezafibrate, or fenofibrate)
- the antibiotics erythromycin and clarithromycin
- HIV protease inhibitors (such as indinavir, nelfinavir, ritonavir, and saquinavir)
- the antidepressant nefazodone
- amiodarone (a drug used to treat an irregular heartbeat)
- verapamil (a drug used to treat high blood pressure, chest pain associated with heart disease, or other heart conditions)
- large doses (≥ 1 g/day) of niacin or nicotinic acid
- large quantities of grapefruit juice (>1 quart daily)

It is also important to tell your doctor if you are taking coumarin anticoagulants (drugs that prevent blood clots, such as warfarin).

Tell your doctor about any prescription and nonprescription medicines you are taking or plan to take, including natural or herbal remedies.

Tell your doctor about all your medical conditions including allergies.

Tell your doctor if you:

- drink substantial quantities of alcohol or ever had liver problems. VYTORIN may not be right for you.
- are pregnant or plan to become pregnant. Do not use VYTORIN if you are pregnant, trying to become pregnant or suspect that you are pregnant. If you become pregnant while taking VYTORIN, stop taking it and contact your doctor immediately.
- are breast-feeding. Do not use VYTORIN if you are breast-feeding.

Tell other doctors prescribing a new medication that you are taking VYTORIN.

How should I take VYTORIN?

- Take VYTORIN once a day, in the evening, with or without food.
- Try to take VYTORIN as prescribed. If you miss a dose, do not take an extra dose. Just resume your usual schedule.
- Continue to follow a cholesterol-lowering diet while taking VYTORIN. Ask your doctor if you need diet information.
- Keep taking VYTORIN unless your doctor tells you to stop. If you stop taking VYTORIN, your cholesterol may rise again.

What should I do in case of an overdose?

Contact your doctor immediately.

What are the possible side effects of VYTORIN?

See your doctor regularly to check your cholesterol level and to check for side effects. Your doctor may do blood tests to check your liver before you start taking VYTORIN and during treatment.

In clinical studies patients reported the following common side effects while taking VYTORIN: headache and muscle pain (see What should I tell my doctor before and while taking VYTORIN?).

The following side effects have been reported in general use with either ezetimibe or simvastatin tablets (tablets that contain the active ingredients of VYTORIN):

- allergic reactions including swelling of the face, lips, tongue, and/or throat that may cause difficulty in breathing or swallowing (which may require treatment right away), and rash; inflammation of the pancreas; nausea; gallstones; inflammation of the gallbladder.

Tell your doctor if you are having these or any other medical problems while on VYTORIN. This is not a complete list of side effects. For a complete list, ask your doctor or pharmacist.

General Information about VYTORIN

Medicines are sometimes prescribed for conditions that are not mentioned in patient information leaflets. Do not use VYTORIN for a condition for which it was not prescribed. Do not give VYTORIN to other people, even if they have the same condition you have. It may harm them.

This summarizes the most important information about VYTORIN. If you would like more information, talk with your doctor. You can ask your pharmacist or doctor for information about VYTORIN that is written for health professionals. For additional information, visit the following web site: vytorin.com.

Inactive ingredients:

Butylated hydroxyanisole NF, citric acid monohydrate USP, croscarmellose sodium NF, hydroxypropyl methylcellulose USP, lactose monohydrate NF, magnesium stearate NF, microcrystalline cellulose NF, and propyl gallate NF.

Issued July 2004



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EDITED BY ROSE BRADY

China: A Workers' State Helping the Workers?

WHEN RETAIL GIANT Wal-Mart Stores Inc. announced on Nov. 22 that its workers in China could set up trade unions, not a few observers were surprised. After all, Wal-Mart is criticized in the U.S. for discouraging union efforts. And China hasn't been known for treating its workers well since it embraced capitalism, either.

What's going on? Wal-Mart says it was only clarifying its longstanding policy of following Chinese law and allowing unions if workers asked for them. In Beijing, though, the announcement was played as a big deal. The reason is politics. President Hu Jintao and Premier Wen Jiabao, having styled themselves as populist leaders, are eager to prove they're serious about supporting China's increasingly fractious working class. "Although [the communists] have brought naked capitalism back into China, it shows they are still the party of the workers," says Robin Munro, research director at China Labor Bulletin, a Hong Kong labor-rights group.

Whether the top leadership is merely pursuing a clever propaganda campaign is open to question. But the action by Beijing is crucial. Workers are increasingly going to the streets. The number of protests reached 10,000 in 2003, estimates Munro. This year more than 500 workers in Dongguan staged facilities and injured a manager at a big Taiwanese maker. "With globalization, the conflicts between workers and employers are becoming very serious," says Chang Kai, director of the Institute for Labor Relations at Peking University in Beijing.

To try to curb the protests, Hu and Wen have been pressing the official All-China Federation of Trade Unions (ACFTU) to expand into more enterprises and push for better working conditions. A relic of China's state-planned past, the ACFTU is viewed as

near-powerless by most Chinese. It "failed to represent workers when factories were taken over by multinationals and had big layoffs. So now there is a real push within the ACFTU to deliver services to members," says Aurret van Heerden, president of the Washington-based Fair Labor Assn.

POLITICAL CAPITAL

IN LATE OCTOBER the ACFTU announced a blacklist of multinational companies accused of blocking Chinese workers from setting up unions. Those targeted included Wal-Mart, Dell, Eastman Kodak, McDonald's, KFC, and Samsung Group. When Wal-Mart later clarified its policy, the ACFTU applauded but also threatened to sue the other companies if they did not

follow suit. "If foreign-funded companies still deny their workers' right to join the unions, the ACFTU will surely pursue litigation against them," an ACFTU official told the Xinhua news agency.

With nationalism on the rise, Beijing's leaders can win easy political capital by fingering labor practices at multinationals. But don't expect a powerful union movement to emerge in China. The ACFTU may try to improve worker conditions but not so aggressively that it encourages strikes at newly unionized companies. What Hu and Wen really want is to calm labor strife, show their commitment to the union cause, and stop efforts by workers to establish their own informal, illegal labor organizations. The workers may not buy it. ■

—By Dexter Roberts in Beijing,
with Aaron Bernstein in Washington and
Wendy Zellner in Dallas



SURPRISE
Wal-Mart said it will allow unions

GLOBAL WRAPUP

A MANAGEMENT TIFF IN EUROPE'S AVIATION BIZ

HOSTILITY IS flaring between Airbus Chief Executive Noël Forgeard and the planemaker's parent, European Aeronautic Defense & Space Co. Forgeard angered Philippe Camus and Rainer Hertrich, dual CEOs of Franco-German EADS, by supporting a French government proposal to install Forgeard as EADS's sole boss. "I cannot comprehend that Noël Forgeard...has such little regard for the international image of the group," Hertrich said in a Dec. 1 interview with German newspaper *WirtschaftsWoche*. France shelved its proposal, but tensions remain over Forgeard's desire to seek government loans to finance the proposed new A350 plane. The EADS board on Nov. 29 delayed a decision on the project amid fears that loans would intensify trade friction with the U.S., thus jeopardizing EADS's efforts to win U.S. defense contracts.

COLOMBIA'S TOUGH POLICY WILL CONTINUE

COLOMBIAN PRESIDENT Alvaro Uribe won the go-ahead from the Colombian Congress on Nov. 30 to run for a second, four-year term in 2006. Uribe, 52, enjoys 72% approval ratings because his crackdown on drug traffickers and the 40-year-old guerrilla movement has led to a dramatic drop in kidnappings, homicides, and terrorist attacks. Uribe plans to continue that policy in a second term—with U.S. help. President George W. Bush recently pledged that he will push the U.S. Congress to add to the \$3.3 billion spent since 2000 by Washington on Plan Colombia, which aims to help eradicate cocaine trafficking and guerrilla activity. Uribe is one of Bush's key supporters in Latin America.

ELITE GROUP Only five companies make plasma screen displays

Pioneer

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Will Plasma Revive Pioneer?

It leads in the largest, superbright TVs. But rivals are in the game, too

FOR YEARS, PIONEER CORP.'S products have been a staple of road trips worldwide. Its car stereos sound great pumping out everything from Schubert to Snoop Dogg, and the company has a long string of achievements to its name, including the first in-dash CD player and the first satellite-based navigation systems—which have helped make the company the world's top manufacturer of high-end car stereos. But in the living room, Pioneer hasn't been as successful, struggling to climb out from the shadow of brands such as Sony, Panasonic, and Philips.

Now, Pioneer believes it can prosper with a technology better suited to the den than the dashboard. The company is betting billions on plasma display panels, or PDPs—superbright TVs thin enough to hang on a wall. After buying out NEC Corp.'s PDP business earlier this year for \$341 million, Pioneer is one of only five companies that produce them—and it's the leading maker of PDP TVs larger than 40 inches, usually used for home theater systems. Since launching its

first PDP in 1997, Pioneer has expanded production aggressively to four factories all located in Japan. Its latest, a \$245 million facility in Yamanashi prefecture, west of Tokyo, opened in September. "People want bigger and bigger TVs, and that means flat panels," says Pioneer President Kaneo Ito.

FEELING THE PINCH

SUCH EXPANSIVE VIDEO real estate today will set you back \$3,000 or more, but as prices fall by 20% per year, more and more consumers are buying. By 2007 the global market for PDP TVs is expected to grow to 6.3 million units, from 2.4 million this year, according to the Photonics Industry & Technology Development Association. So Ito plans to ramp up production to 1 million units by 2007, from 480,000 today. PDPs accounted for about 8% of Pioneer's overall sales of \$6.4 billion last year, and it's aiming to make that 16% this year. Although Ito won't disclose profits from PDPs, Ito says the business is in the black.

Those numbers still aren't enough to compensate for shrinking margins elsewhere. Profits for once-lucrative Pioneer products such as

Margins are falling in Pioneer's core car-electronics business

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The Corporation Strategies

DVD recorders, cable set-top boxes, and computer hard drives have hit the skids as competitors have flooded in. Even Pioneer's mainstay car electronics business is being pinched. In the quarter ended on Sept. 30, sales of Pioneer's car stereos, navigation systems, and other auto-related products grew 11.9%, to \$679 million, but income from the segment dropped 26%, to \$42 million.

"NEGATIVE IMPRESSION"

THAT COULD SPELL trouble. Despite its PDP ambitions, car electronics still make up 42% of Pioneer's sales, while home electronics (which includes PDPs) account for 40%. Sales rose in both areas in the first half of the year, but profits fell steeply—spurring Pioneer to scale back shipments of many products, including DVD and hard-disk drives for computers. On Oct. 28 the company slashed its profit forecast by 60%, to \$91 million on sales of \$7.3 billion for the full year through March. Just four months earlier, Ito had said he was confident Pioneer would meet its profit targets. "[That] left a very negative impression," says Yuki Fujimori, an analyst at Goldman, Sachs & Co. in Tokyo. No kidding: The stock dropped 10% in one day of trading.

The bet on plasma, meanwhile, won't start paying big dividends anytime soon—if ever. Although buying NEC's PDP unit will boost sales by about \$273 million, the deal won't do much for profits because NEC had big inventories sitting in warehouses. And while it's true that only a handful of companies make PDPs, Pioneer is small fry compared with the others: Matsushita Electric Industrial, LG Electronics, Samsung SDI, and a Hitachi-Fujitsu joint venture. The danger is that the profits Ito is banking on won't materialize even as sales mushroom. Morgan Stanley analyst Masahiro Ono notes that Pioneer was one of just two electronics makers to come out with new plasma TVs and DVD recorders in time for the Athens Summer Olympics. But while

the other—Matsushita—posted better-than-expected quarterly profits, Pioneer came in below estimates. On Nov. 22, Deutsche Bank analyst Yasuo Nakane lowered his target price for Pioneer stock by 10.5% on fears that growing competition in PDPs will further squeeze margins.

There's another problem: The other players have all hedged their plasma bets by also manufacturing liquid-crystal-display-panel TVs. That rival technology is better suited to smaller screens—under about 40 inches. But advances in technology may allow LCD makers to some day challenge PDPs on size and bring down costs to levels that undercut prices of PDPs. Pioneer execs, though, say the company is making enough improvement in both its manufacturing processes and the underlying technology to stay ahead of LCD screens both in terms of image quality and price. "There's no doubt that LCD screens are growing larger, but we aren't worried," says Masaru Saitome, chief of Pioneer's PDP operations.

Pioneer execs concede that the pace of the price declines for PDPs has been faster than anticipated. But Ito says the company is on track to boost profits overall in line with sales

The bet on plasma won't start paying big dividends soon

as it reins in costs. Over the past decade, Pioneer has shifted 62% of its production overseas, much of it to China. To wring more profit out of the DVD-R business, Ito says Pioneer will consolidate manufacturing in Shanghai over the next six months and source key parts locally instead of shipping them from a plant further inland. The company

is also working to trim costs across the board by reducing the number of parts it uses, and it's continuing to look for cost savings through technical innovation. Pioneer's latest-generation PDPs, for instance, require just two layers of specialized glass instead of three, which Ito says has resulted in savings of 30%. "We've cut the number of parts used in PDPs in half compared to our first-generation products," he boasts. Of course, there's no guarantee that the likes of

Matsushita and Samsung

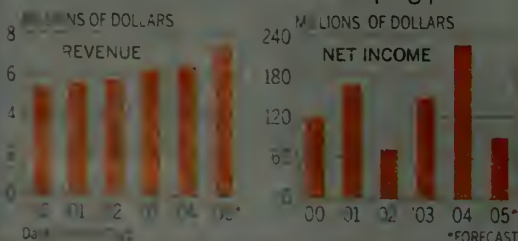
Group won't beat Pioneer at the cost-cutting game. But if Ito can keep a lid on costs as production volume mounts, the flat-screen bet may make Pioneer's road trip a whole lot smoother. ■

—By Chester Dawson
in Tokyo

MARGIN SQUEEZE

Pioneer's sales are on a tear...

...but profits aren't keeping pace



CEO ITO He surprised investors by cutting profit targets

Our two-room suites.
vision that came to us on the way to
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PUTTING HYBRID TRUCKS TO WORK WHEN DISASTER STRIKES.

If there were ever any doubts that hybrid vehicles could deliver the same power as their traditional counterparts, they were quickly erased this summer.

As a fleet of hybrid trucks rolled into Florida in the wake of this season's hurricanes, everyone knew they'd help get people and supplies where they needed to go. But in times like these, it seems the real benefit of a hybrid engine is mobile electricity. And with accessory power outlets standard on every GM hybrid, these trucks — capable of running power tools or doubling as generators — actually pack more power than their predecessors.

When power lines are down, it's these outlets — two in the cab and two in the cargo box — that really make an impact. Whether it's running the power tools that help to restore homes, plugging in much-needed medical equipment or just providing some lamplight, electricity plays a critical role in the rebuilding process.

Real world problems. Real world solutions. We're glad our hybrid trucks — the Chevy Silverado and GMC Sierra* — have been able to provide assistance in Florida. But that's just the beginning. In 2006, we plan to introduce a hybrid version of our Saturn VUE. After that, we plan to offer these engines in the GMC Yukon, Chevy Tahoe and Chevy Malibu.

So while they're saving energy, hybrids are also producing it in ways we've never seen before. Which means the question isn't, are they powerful enough? It's more like, how much power do you need?



CHEVROLET PONTIAC BUICK CADILLAC GMC OLDSMOBILE SATURN HUMMER SAAB

Drilling with The Big Boys

At ConocoPhillips, CEO Mulva is creating a truly integrated global oil giant

WHEN CONOCO and Phillips Petroleum announced plans to merge in late 2001, it looked to some like a desperate move to survive in a business squeezed by falling oil and gas prices and increasingly dominated by such giants as ExxonMobil and ChevronTexaco. But more than two years after the marriage was completed, ConocoPhillips is proving that it's nimble enough to play with the big boys as it takes larger risks around the globe.

Certainly, soaring oil and gas prices and robust refining margins have played a major part in lifting the Houston company's fortunes. With oil surging past \$50 a barrel, 2004 profits should jump 64%, to \$7.6 billion, according to a Thomson First Call survey of analysts; revenues are expected to rise 30%, to \$135 billion. Hefty cost-cutting helped vault the company to No. 8 on last spring's *BusinessWeek* 50 ranking of top-performing companies. More important for future growth, though, ConocoPhillips has assembled a promising pipeline of oil and gas projects—including its recent \$2.6 billion stake in Russia's biggest oil company, Lukoil.

Chief Executive James J. Mulva, 58, is well on his way to fulfilling a longtime goal: creating a truly integrated oil giant. "He wanted membership in the exclusive club," with the likes of ExxonMobil, BP, and Total, says Oppenheimer & Co. senior oil analyst Fadel Gheit. Mulva's dealmaking streak began with the acquisitions of Atlantic Richfield Co.'s Alaska production assets in 2000, followed by independent refiner Tosco Corp. in 2001. Then came the \$16 billion Conoco deal, for which the hard-charging Mulva paid no premium. ConocoPhillips had proven reserves of 8.1

billion barrels of oil equivalent at the end of 2003, vs. 22 billion for ExxonMobil and 12 billion for ChevronTexaco. "We certainly believe we have the scope and size to compete with the largest companies in the industry, but not in every part of the world. So we have to be more selective," Mulva told analysts on Nov. 17. He declined to talk to *BusinessWeek* for this story.

The bigger oil companies still command



richer stock multiples thanks to stronger balance sheets and more assets. But ConocoPhillips' improvements on capital—now near the high end of the range of its bigger peers—have earned kudos from investors. Hefty profits helped ConocoPhillips pare debt from \$22 billion at the start of 2003 to an estimated \$15 billion at the end of this year. The company also moved quickly to shed nearly \$1 billion in assets, including mature oil and gas properties and gas stations, and cut 22,000 jobs. "They have an exceptionally strong financial position now," says analyst L. Bruce Lanni of A.G. Edwards & Sons Inc. Since January its stock, which trades at about \$90, has returned 40% to shareholders, vs. 32% for the Standard

Poor's 500 Integrated Refining & Gas index.

Mulva joined Phillips in 1973 and rose through the company's finance ranks. His selection as CEO in '99 was a bit of a surprise; he was considered a dark horse in a company where normally favored executives

had been vying for the top post. Now, with acquisitions out of the way for a while, the company is focused on methodically building formidable strongholds in some of the world's richest oil and gas regions. Mulva

is investing in carbon capture technology, chosen refining processes that will let the company handle more of the heavier, lower-quality oil that increasingly makes up the world's supplies and that ties up the company's production in such places as Venezuela and Canada. With more reliance on U.S. refining than most of the other major oil companies, ConocoPhillips is expected to benefit in the coming years from tight refining capacity and growing demand.

Building on its production base in places as Alaska and the North Sea, ConocoPhillips should see healthy 5% annual growth in oil and gas volumes for at least the next two years, analysts say. But Mulva promotes "sustainable growth" over the long term as he moves to riskier projects in



KOGALIM, RUSSIA

A stake in Lukoil will grow to 10% by yearend

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sia, Asia, and the Middle East. "Executing in each place is different, and only time will tell," says J. Robinson West, chairman of consultant PFC Energy. But he wouldn't bet against Mulva. "Jim is very disciplined, very smart. He never lets up. He never stops."

"THE ENTRY TICKET"

MULVA'S PERSISTENCE paid off in September—after 18 months of negotiations—with a 7.6% stake in Russia's Lukoil. That will grow to 10% by yearend and as much as 20% over the next few years. While analysts worry about the amount of control ConocoPhillips will exert with a minority stake in a country plagued by legal and political uncertainty, Mulva did win a board seat and veto power over decisions involving corporate reorganizations, stock issuance, and other moves. He's also paying \$400 million for a 30% interest in a joint venture with Lukoil in the northern part of Russia's Timan-Pechora province. His stake is small compared with the Russian investments of giants such as BP, which last year paid \$8 billion to form a 50-50 joint venture with oil company TNK. "ConocoPhillips is coming late to the party in Russia, and it's really doing it indirectly," says analyst John B. Parry of energy consultant John S. Herold Inc. Still, he calls the Lukoil deal "the entry ticket" to that region's rich oil reserves.

One of the biggest risks facing ConocoPhillips is a crash in oil and gas prices, which few consider likely anytime soon. But in that event, ConocoPhillips might become a consolidator, gobbling up bigger independents. For now, its own independence seems assured thanks to CEO Mulva's savvy dealmaking. ■

—By Wendy Zellner in Dallas

GOING TO THE WELL

ConocoPhillips has built a strong portfolio of exploration projects—and returned more than other big producers



Xerox Is Dreaming in Color

Will a big bet on color printing boost its share in this fast-growing market?

AT FIRST BLUSH, THE sales pitch left graphic designers at PrintManagement skeptical. Xerox Corp. was trying to sell them on a new digital copier called iGen3 that would take over some of the work the Cincinnati printer traditionally sent to offset machines. The color would be comparable, Xerox claimed in the presentation last March. And it would be economical for runs of fewer than 2,000 pages—a proposition no high-volume offset-printing system could match.

These two claims intrigued the designers, who print millions of color pages every year. "We have clients that manufacture

The R&D outlay is huge, but the profits are lush

equipment for the food industry," says Brian Frank, PrintManagement LLC's co-owner and executive vice-president. In their product brochures, "a piece of chicken has got to make your mouth water." So Frank sent a host of jobs to Xerox' Rochester (N.Y.) compound, and when they came back, the designers put them next to the same prints run on an offset machine. Within a couple of weeks, PrintManagement signed a five-year lease on an iGen3 for upwards of \$750,000.

Xerox needs to impress a lot more execs like Frank. The copier giant targeted the color market years ago in part to escape price wars in low-end systems. It now enjoys a dominant 36% market share in high-end color copiers, where leases



VIBRANT PLAN
Burns says the investment is paying off

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run \$150,000 and up. But sanctuary in this niche could prove transitory: Rival Canon Inc. is No. 1 in mass-market copiers that handle both color and black and white. Ricoh, Toshiba, and Konica Minolta are competitive, too. And Hewlett-Packard Co. hopes to move its corporate clients to multipurpose office machines with brilliant color palettes. "Color's the name of the game these days," says Peter A. Crean, a veteran Xerox scientist.

The stampede into color office gear is driven in part by the explosion of radiant Web pages, graphics-rich PowerPoints, and relentless blizzards of brochure marketing. And because color products require more supplies, profits in this segment are lush. Xerox' profits in the color copier market—mostly on toners and other gear—are three to five times higher than in the black-and-white market.

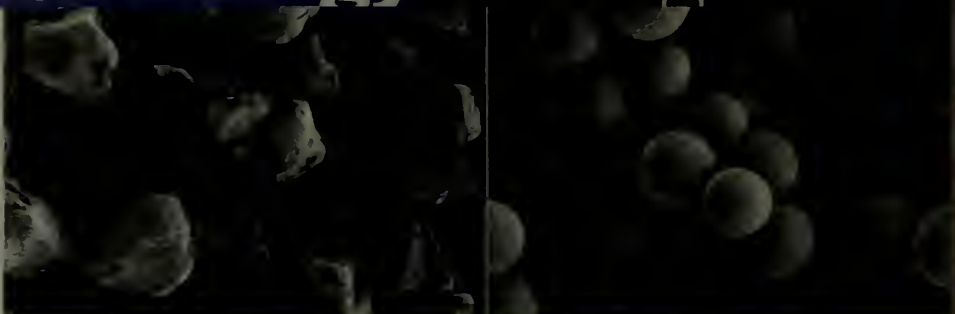
ALL IN THE MIND

THE GROWTH CURVES are also alluring. While black-and-white copier sales are basically flat, color office machines that copy, scan, and fax are expected to swell from a \$5.8 billion market in 2003 to \$7 billion this year, according to Lyra Research Inc. in Newton, Mass. Xerox gets 24% of revenue from color sales—but that's not good enough, executives say. To increase their share, the company is spending two-thirds of its \$800 million annual research and development budget on color-related projects.

For all the intense research at Xerox and elsewhere, the physics of color is fairly elementary. Virtually all printed colors can be produced by combining four shades: black, cyan, magenta, and yellow. But the science of color is as much about human perception as it is about wavelengths of light—and matching the color on a piece of paper with what's on a computer screen is no mean feat. Xerox dubs this challenge "true color" and it is sparing no science or engineering resources to master it.

Calibrating printed colors with their electronic counterparts is difficult because the colors on a monitor are literally luminous: You change them by adding light. On a page, in contrast, when you want to refine the palette, you mostly end up applying the color black to subtract light. Not surprisingly, the universe of colors you can see on a computer or TV screen is much larger than what you can ever get on a page.

To outdo rivals, Xerox is aiming for the goal of "true color" reproduction



Building Better Toners

THE OLD WAY...

The conventional toner used in photocopiers is ground up and sifted to get tiny particles that are roughly uniform in size and shape. Even after decades of evolution this mechanical process cannot produce perfectly matching particles.

So researchers have figured out how to trick the eye into believing that the two sets of colors match. For one thing, the perception of a particular hue is defined by colors adjacent to it. The same patch of yellow surrounded by a light blue background seems to grow brighter as you darken the blue that borders it. By deftly layering colors next to one another, printed images can emulate electronic ones.

But all this effort is wasted if the colors placed on the paper aren't "true." Here, nanotechnology comes into play. Traditionally, the toner used in photocopiers was ground up and sifted to get the most uniform particles. Today, after 11 years of development, toner in several of Xerox's high-end office color-copying machines—and likely soon the iGen3—is made chemically, built up from molecules that measure just one four-hundredth the width of a human hair. This technique has improved color reliability. And because the particles are a uniform size, copiers and printers handle them efficiently, with little waste.

Rivals and some outside experts question how effective Xerox' research spending will be. Sam Yoshida, a corporate systems director at Canon USA Inc., points out that Canon can leverage its color research across a variety of digital products, including cameras, video, and copiers. That gives the company more bang for its research buck, he contends. And Michael Zeis, president of document specialist Blackstone Research Associates, expresses doubts

THE NEW WAY...

Today, after 11 years of development, toner in several of Xerox' high-end machines is engineered and manufactured chemically, from the molecules up. Their uniform size has improved color reliability and allowed the copiers to run more efficiently.

about the potential market for products such as iGen3, which is designed for customized tasks. Because it's digital, the machine might run, for example, a few thousand high-gloss fliers for a resort customized to the interests of many different groups of clients. But there is one big problem, says Zeis: Many companies lack sufficient information about the customers to really tailor their marketing in such a detailed way.

Xerox says its color strategy is far more than just neat science. Ursula M. Burns, president of business group operations, the company's \$12 billion copier division, says return on R&D investment has been strong and that color innovations hatched originally for one machine migrate up and down Xerox 30-product color line.

Solid ink is a prime example. The technology, which Xerox acquired five years ago, is an ink formed into roughly 2-inch square pieces that are melted to make an image, creating deeper, truer colors on the page. At Behr Paint kiosks, located in 1,700 Home Depot stores, it's a Xerox solid ink printer that spits out the sample.

Today the ink is used in printers, but Xerox has been working on a way to get into digital machines that copy, fax, and print—and plans to launch such a machine in the first half of 2005. Customers like the vivid colors, but just as important to Xerox is the lower cost base: Solid-ink systems have fewer disposable parts, and maintaining them costs 40% less than traditional laser systems.

For a company built on a leasing model, maintenance savings are a huge boon. "Solid ink is magic," says Burns. We make that science. ■

—By Nanette Byrnes in Rochester, N.Y.

ODE TO THE FEARLESS.

We live in an age where fearless thinkers are transforming the way we live, work and play. Organizations are realizing that the true power of their information is unleashed only when it is readily available, not safely locked away. Business leaders are learning that success comes from letting their people do what they do best—wherever, whenever and however. That having to choose between protecting information and making it available is a choice from the past. That real security is an open door, not a closed one. That when information has no limits, followers become leaders and leaders become pioneers. This is the new world. And in this world, the ones who are fearless are the ones who will lead. **Will you be among them?**

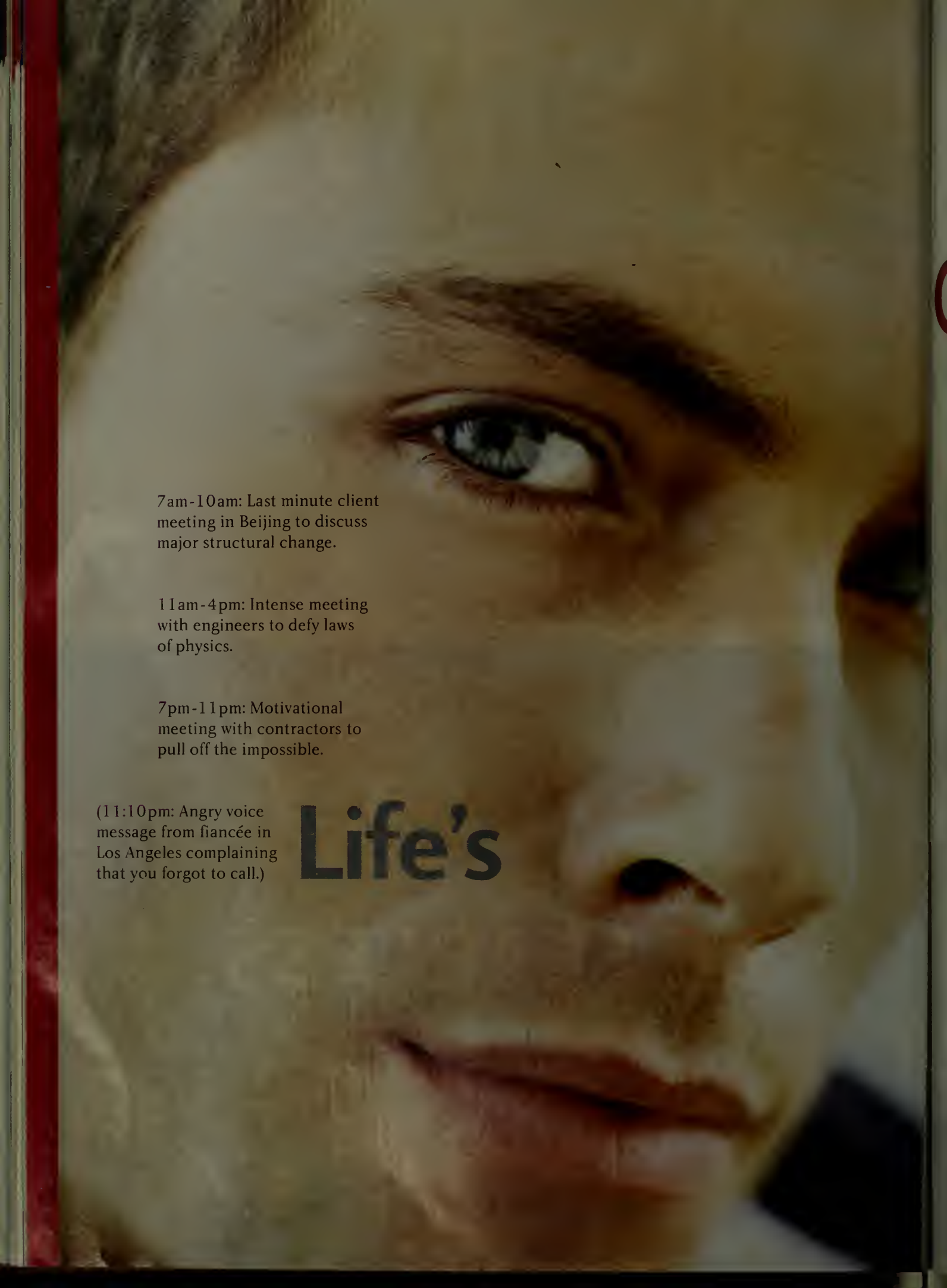
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Served in Iraq? Come Work for Us

Reservists—and the skills they've honed—are in demand at a slew of big companies



IT WAS JUST THE EVENING commute home. On Mar. 30, Marine Corps Major Keith Canevaro was commanding a convoy of 30 civil affairs troops back to their camp after a day of work at the provincial government center in Ramadi, in the heart of Iraq's insurgent-plagued Sunni Triangle. That's when a roadside bomb exploded ahead of him. The Humvee in front of Canevaro burst into flames. Shrapnel cracked the protective glass of his windshield. Insurgents opened fire from all around with small arms and rocket-propelled grenades.

Following a plan Canevaro had laid out during a morning briefing, the soldiers went into action. Designated medical personnel rushed to help the four wounded Marines. Others set up a defensive perimeter and began returning fire. Canevaro saw suspicious mounds and debris in the road, which warned him there were perhaps other bombs. Working multiple radios, he called in for a special explosives unit, a medical helicopter, and combat air support. Canevaro figured his team's quick response repelled the attackers and saved lives. The Marine Corps agreed, awarding him a Combat Action Ribbon for his performance.

TREMENDOUS PRESSURE

WHERE'S CANEVARO today? He's back home in Petaluma, Calif. Finishing up his military work, the stocky 35-year-old will return next month to his job as a program manager for optical telecommunications products at Cisco Systems Inc. Says Canevaro of his military experience: "Any young lieutenant who leads a platoon has had a lot more responsibility thrust at him than most people in the business world."

Not since World War II have so many reservists such as Canevaro seen combat. Nearly 180,000 are on active duty, and they make up 40% of the troops in Iraq. This reliance on the nation's citizen-soldiers puts tremendous pressure on the reservists, their families, and their employers back home. At times the system seems to be cracking. Reserve units were behind the Abu Ghraib prison scandal and the recent decision by one group of soldiers to refuse a mission after declaring their equipment unsafe. Both groups are facing disciplinary action by the military. Meanwhile, pundits, the media, and politicians continue to debate whether the country needs a larger regular

CANEVARO He'll soon be back at Cisco after leading a Marine Corps unit

needs a larger regular



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Despite the myriad problems, reliance on citizen-soldiers in combat has brought some unheralded benefits to the military, including the reservists' entrepreneurial savvy and maturity—their average age is 32, four years older than the average active-duty soldier. And they often bring much-needed expertise in specialties such as information technology, health care, and construction.

What's less well-known is how much of a boon reservists are becoming to Corporate America. They return from their military service with far more seasoned management, people, and communication skills. That's why many big companies are going out of their way to recruit and retain them. Federal law requires that employers give reservists returning from military service their jobs back with the same level of responsibility and pay. But Adolph Coors, American Express, General Electric, Harley-Davidson, and Home Depot find the citizen-soldiers so qualified that they actively recruit them, offering perks such as continued pay and health-care benefits when they are called into active duty, a practice known among reservists as double-dipping (table). "These are people who have to deliver results," says Dennis M. Donovan, executive vice-president for human resources at Home Depot Inc. "They have to think not just tactically but strategically. And they have to inspire people."

"SELLING DEMOCRACY"

JEFFREY CANTOR, a 38-year-old sales manager from Marlboro, N.J., who works for pharmaceutical maker AstraZeneca International, last year found himself in the Iraqi city of Kirkuk. The U.S. Army civil affairs officer was assigned to help establish a local government amid warring ethnic and religious factions. At Kirkuk's first city council meeting, an angry Sunni resident stood up to complain about protests in the streets that were frequently turning violent. At the heart of his complaint, Cantor reasoned, was the fear that the Kurds and other ethnic groups were gaining power at the expense of the Sunnis. As a sales manager, Cantor often had to mediate disputes between sales reps. So he drew on that experience, calming the man down by explaining that everyone would be given an equal chance to voice opinions and that the right to free

debate was better than when divergent views were stifled by the government. "I'm a salesman," Cantor explains. "I was selling democracy."

When they return to the civilian world, reservists often arrive with leadership skills they have honed in combat. Army Major David Wood, 41, commanded a helicopter squadron in Iraq and

to be on the field, leading from the front.

Reservists are also well-schooled in the art of compromise. Last year, John Pippy 33, commanded an Army engineering unit in Iraq, overseeing construction workers in desert heat of 135F. He's now state senator in western Pennsylvania. Last summer he found himself using his recently polished skills in the legislature,

where he reluctantly voted in favor of legalizing slot machines in the state—but only after securing funding from fellow lawmakers to make improvements at Pittsburgh International Airport. "A large part of my time in the military has been spent not being independent but on bringing coalitions together," says Pippy.

Still, heeding Uncle Sam's call can put a huge strain on many reservists' careers. Although employers are required to restore their jobs, small businesses can't always comply and many are deeply burdened when an owner heads off to active duty. Many families see their incomes slashed when reservists move from civilian jobs to relatively paltry military pay checks. U.S. Navy reservist Warren White, 35, spent six months on active duty in Iraq last year, which took a big toll on his employer, a company that installs home-security and entertainment systems in the St. Louis area. After he got back in January, it took him six months to regain his pre-leave level of sales. And, of course that's not to mention those who come back wounded, maimed or so psychologically damaged that they are unable to return to their jobs at all.

The military acknowledges that the present system of leaning so heavily on reservists needs fixing. Strategic planners inside and outside of government are studying ways to

maximize the use of the reserves without burning out the reservists. But so far, Corporate America isn't complaining. It turns out that the U.S. involvement in Iraq, whatever else it has come to stand for, has become an unlikely but effective business boot camp. ■

—By Christopher Palmeri in Los Angeles, with Brian Grow in Atlanta and Stan Crock in Washington

These Companies Want You



Federal law requires that employers give reservists returning from military service their jobs back with the same level of responsibility and pay, but some employers go further:

ADOLPH COORS Makes up the difference between a reservist's regular salary and military pay for up to one year of active duty. An internal volunteer organization works with reservists' families, boxing and shipping donated items to the troops.

AMERICAN EXPRESS Provides full pay and benefits for up to five years as well as cash contributions to the employee's retirement plan.

GENERAL ELECTRIC Pays one month of full salary and makes up the difference in pay for up to three years. GE has a military recruiting division and leadership programs for military members transitioning to the corporate world.

HARLEY-DAVIDSON Mobilized employees receive the difference in pay and benefits plus frequent care packages. Reservists and veterans make up 14% of the company's employees.

HOME DEPOT Pays the difference in salary for entire length of duty for reservists called since Sept. 11, with more than 1,800 currently serving. The company has partnered with the Defense Dept. to put job information on government Web sites and in career centers. Employees can get transferred to another Home Depot store if the military moves their spouse to a new base.

Data: Military reports the Defense Dept.'s National Committee for Employer Support of the Guard and Reserve

Afghanistan. Wood says his soldiers always seemed more enthusiastic about a mission when they knew a senior officer was taking part. Back home, as a vice-president at Jay Group, a packaging company in Ronks, Pa., Wood says he now often goes down to the plant floor to pack and ship products alongside workers. "You can't be what we call a coffee-cup commander," Wood says. "You have

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The \$600 Million Circus Maximus

How Cirque du Soleil keeps the blockbusters coming

IT'S ONE WEEK BEFORE THE opening night for a new Cirque du Soleil show at the MGM Grand Hotel & Casino in Las Vegas. A dozen acrobats are in rehearsal, hanging from a giant metal stage that rotates up at an angle to simulate an icy cliff. One by one, the spikes they cling to will disappear into the stage, sending the performers sliding into a 50-foot pit below. Spontaneously, the acrobats begin crying out, not for mercy, but for a steeper incline. "We want danger!" they quip.

It's just another day in the bizarre world of Cirque du Soleil, the French-Canadian acrobatic troupe that has built a \$600 million-a-year entertainment empire combining daredevil stunts with cutting-edge technology—and a devoted public that will pay almost any ticket price (from \$40 to \$195) to see the elab-

orate shows. On Nov. 26, Cirque opened its latest production, *Kà*, at the MGM Grand. The extravaganza—complete with giant puppets, archers shooting flaming arrows, and a spinning contraption called the "Wheel of Death"

—cost \$165 million to stage, more than all 36 Broadway productions last year.

Kà could well be a turning point for Cirque. It's the first of its productions to have a cohesive story line as well as the first to include simulated battles and martial arts. Four years in the making, *Kà* also highlights the elements, from sparkling costumes to hypnotic original music scores, that keep the 20-year-old company packing the house.

Yet even with its huge successes and distinctive style, a growing flock of competitors in the world of entertainment spectacles has Cirque creators spending heavily to stay ahead of the pack. Indeed, *Kà* represents a risk that Cirque, with five touring productions and five more in residence in Las Vegas and Orlando, will saturate the market for its ethereal brand of entertainment. "There are only so many touring shows and productions they can stage," says Robert David, a professor of business strategy at Montreal's McGill University. "There is a

VEGAS LURE Cirque shows draw 2 million a year to MGM casinos



limit, and they're getting pretty close."

Like most other Cirque shows, *Kà*, which means "fire" in Japanese, has been a group process. The project began in 2000 when casino giant MGM Mirage told Cirque founder Guy Laliberté that it wanted a new attraction for the MGM Grand, which was launching an upgrade of its restaurant and entertainment offerings. The casino giant agreed to foot the entire bill for a \$135 million, 1,900-seat theater built according to specs just for *Kà*. Some \$30 million more in costumes and other production costs are split evenly between Cirque and MGM. So are the profits. Like the three other Cirque shows playing at MGM casinos in Las Vegas—*Mystère*, *O*, and *Zumanity*—this production will never tour, creating an only-in-Las Vegas mystique that is part of the draw—and which also assures MGM its steady cut.

STILT-WALKER

THE 45-YEAR-OLD Laliberté has always thought big and looked for wealthy backers to help him realize his visions. The son of an Alcan Aluminum Corp. public relations executive and a nurse, the Montreal native quit college and toured the world as a fire-breather and stilt-walker before helping organize a summer fair at a local artist colony near his hometown. After the community encouraged his team of scruffy acrobats to hit the road, Laliberté pitched a touring version of the show to the provincial government of Quebec in 1984, eventually scoring \$1.6 million in funding tied to a celebration of the 450th anniversary of Canada's discovery by explorer Jacques Cartier.

Laliberté early on devised the formula that would launch his quirky circus into international prominence: Promote the show and not the more easily replaced performers; eliminate spoken dialogue so that the productions appeal to diverse audiences; and most important, cut out expensive and controversial animal acts. "I'd rather feed three acrobats than one elephant," he said at the time. Laliberté bought out his longtime business partner, Daniel Gauthier, three years ago for an undisclosed sum. With the opening of *Kà*, Cirque expects to generate \$600 million in sales next year. The company does not disclose profits.

Laliberté relies on an international staff to help run his empire. Three years ago he hired Daniel Lamarre, a

Canadian executive with a background in broadcasting and public relations, to serve as Cirque's president and COO. That freed Laliberté, who is referred to in show credits as Cirque's "guide," to serve as chief critic for the productions. After watching *Kà* for the first time, he delivered three hours' worth of notes on everything from the color of the costumes to the use of projected images. "He's the most fantastic audience you can have," says Lyn Heward, president of Cirque's live shows division. "He has an incredible feel for how the public will react."

Cirque executives are betting that Laliberté is right again and that folks will shell out big bucks to see *Kà*—seats range from \$99 to \$150. Cirque generates about 80% of its revenues at the box office; the rest from show-related merchandise, including custom clothing and \$39 DVDs of Cirque touring productions such as *Quidam* and *Varekai*. And Cirque gets plenty of help from MGM Mirage, its deep-pocketed partner. MGM's three existing Cirque shows bring more than two million visitors a year into its casinos. Only 20% of



The risk for founder Laliberté: That he is saturating the market

Big Bucks Under The Big Top

Kà, Cirque du Soleil's new production, which opened on Nov. 26 in Las Vegas, cost more to stage than all of last year's new Broadway shows combined. A breakdown of the costs and where the money will come from:

THE THEATER Partner MGM Mirage is fronting the \$135 million cost of *Kà*'s performance space, which boasts a 100-foot-high stage with a tilting floor.

THE PRODUCTION Cirque and MGM Mirage split the \$30 million cost of the costumes and crew, comprising over 70 performers.

THE PAYBACK The theater's 1,951 seats are expected to be filled for 10 shows a week at an average \$110 per ticket. Bottom line: *Kà* could bring in \$2 million a week.

Data: Cirque du Soleil

them actually stay at the casino hotel that hosts the show, but showgoers drop an average of \$30 apiece on dinner or drinks at the property. Based on ticket and merchandise sales alone, MGM figures it earns a return on its total investment in the mid-teens, only slightly below the 18% return it shoots for with its casinos overall. And the Cirque shows expose the casinos to a desirable base of consumers. "They're sophisticated, and they have high incomes," says Robert Baldwin, president of MGM's Mirage Resorts division.

"MOVING TARGET"

CIRQUE'S SUCCESS HAS spawned imitators, many of them from the troupe's own ranks. Former Cirque executive Normand Latourelle is touring the U.S. with an

equestrian-themed show called *Cavalria*. Longtime Cirque director Franco Dragone will open a Cirque-like water show in April at the new Wynn resort down the strip. Even so, "they're very clever business people," says Paul Binder, founder of the nonprofit Big Apple Circus, which will put on its show in nine cities next year. "It makes it very difficult for those of us who have limited budgets to compete."

All of which explains why Laliberté and MGM spend lavishly to keep the audience wowed and competitors trying to play catch-up. In 2006 the pair will launch a \$140 million Beatles tribute show at the Mirage casino in Las Vegas, done with the permission of Paul McCartney, Ringo Starr, Yoko Ono, and George Harrison's widow, Olivia. The Fab Four's legendary producer, George Martin, is part of the creative team. "We're constantly challenging ourselves," Laliberté says. "The entertainment business is a big jungle and we have to stay alert."

"They're a moving target for competitors," says W. Chan Kim, a professor at France's INSEAD business school who has written about Cirque. Marvels Kenneth Feld, owner of the Ringling Bros. and Barnum & Bailey circus: "If you think about spending \$165 million on a show that seats 1,900 people, the economics are just staggering." It's enough to take even an acrobat's breath away. ■

—By Christopher Palmeri in Las Vegas

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COMMENTARY

BY DEAN FOUST

How to Keep Duffers on the Fairway

Unless golf changes its rules and marketing, it risks a steady drain of players

AS THE PGA TOUR closes the books on another successful season, this should be the best of times for golf. Tiger Woods, a hot ticket even when he's slumping, and resurgent rivals like Vijay Singh and Phil Mickelson kept TV ratings for the men's tour strong. And rising teen phenoms such as Paula Creamer and Michelle Wie created new buzz around a

women's tour that is desperately trying to break out of the shadows.

Indeed, golf has drawn so many new fans that it stands second only to the NFL in total TV viewership. The pro tour is cashing in: TV revenues for the PGA were on pace to climb nearly 42% this year, to roughly \$230 million—more than four times the payout from just a decade ago.

Look beyond the pro circuit, however, and the grass isn't so green. According to the National Golf Foundation, the number of rounds played by all golfers has declined over the past three full years and was up just 1.3% through the first nine months of 2004. Equipment makers are struggling, with sales of clubs and balls largely flat since the late 1990s. That has led to a shakeout of smaller clubmakers like Orlimar Golf Co. and a bankruptcy auction last year for ballmaker Top-Flite Golf Co. There is talk that Callaway Golf Co. could get bagged by Nike Inc. (BW—Nov. 15).

These statistics suggest that many of the newcomers lured into the game by Woods have concluded that golf is an expensive, time-consuming, and frustrating endeavor. While industry officials boast of the 26 million people who now play golf, the dirty secret is that nearly 3 million quit the game each year—leaving the industry hunting for new players just to stay even.

It doesn't have to be that way—because there are plenty of steps golf could take to expand the game. For starters, the blue-coats at the U.S. Golf Assn. (USGA) and Britain's Royal & Ancient Golf Club—the two governing bodies—need to lighten up about new equipment technology.

The standard-setters say they're just trying to preserve the

game's integrity. But the reality is that they seem obsessed with holding back the technology that would allow tour pros—who are now hitting average drives approaching 300 yards—to further obliterate the courses they play in tournaments. In the process, the high priests are creating too many obstacles for clubmakers trying to develop drivers and irons that would make the game fun for newbies. "The rule-making bodies simply and as a matter of fact don't care about the business of golf," complained Ronald A. Drapeau, then CEO of Callaway Golf Co., at an industry conference earlier this year.

The solution is simple: force the pros to play with "limited distance" balls, a reform Jack Nicklaus has advocated for years. USGA officials insist that the beauty of one-size-fits-all standards is that they make pros and duffers part of the same game. But

most players don't aspire to play the same game as the pros (in fact, only 14% of players even bother to keep a USGA handicap). At the same time, the sanctioning bodies need to become more flexible in their approvals of new clubs—and not reject any new technology that moves the needle forward.

But snazzy new clubs aren't the only answer. There's a lot the rest of the industry could do. More owners should take the lead of M.G. Orender, an owner of four Florida courses and past president of PGA of America, the body representing club pros and instructors. Four nights a week, Orender hosts special six- to nine-hole outings—a "singles night" with cocktails, a couples' league, and a "six [holes] after six" program for women golfers who want to play a few holes on the way home. And on Saturday mornings, he offers a special rate for "soccer dads" hoping to squeeze in nine holes before their children's games start, as well as programs for kids. "Eighteen holes isn't a magic number for the average golfer," notes Orender. "We have to package our product differently." Other course owners are going one further, creat-

ing special kids' tees—and even short "pitch and putt" courses for younger players. Along with more forgiving equipment, such efforts might help ensure that the masses don't slip back into seeing golf as just another spectator sport. ■



**Nearly
3 million
golfers give
up the game
each year**



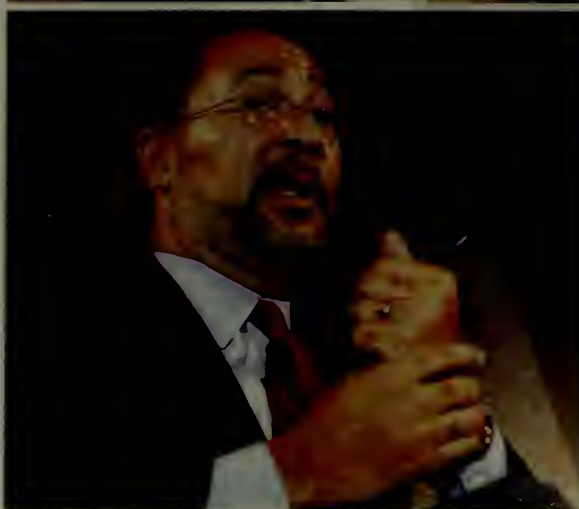
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CHARLES PRINCE
CEO of financial giant Citigroup

MICHAEL CHERKASKY
CEO of insurer Marsh & McLennan

RICHARD PARSONS
CEO of media powerhouse Time Warner

A Compelling Case For Lawyer-CEOs

In litigious times, more companies are seeking legal talent at the helm

MICHAEL G. CHERKASKY is not an obvious candidate to run the world's largest insurance brokerage. A former district attorney, the new boss at Marsh & McLennan Cos. has spent much of his career chasing crooks and has virtually no experience in financial services.

But Cherkasky has one credential that outweighs all of his obvious shortcomings: a close relationship with Eliot Spitzer—who used to work for him in the

Manhattan district attorney's office. On the day Cherkasky was elevated to CEO at Marsh in late October, the threat of a potentially lethal criminal charge against the reeling company by the New York State attorney general suddenly evaporated.

Cherkasky belongs to a specialized breed: lawyer-CEOs. They're a lot more common than you probably think. Other members of the group include Ken-

neth I. Chenault (American Express), Richard D. Parsons (Time Warner), Charles O. Prince III (Citigroup), Sumner M. Redstone (Viacom), and Franklin D. Raines (Fannie Mae). According to head-hunting firm SpencerStuart, 10.8% of the CEOs of companies in the Standard & Poor's 500-stock index have law degrees.

Nearly all of these executives have had to overcome a common prejudice: that lawyers make bad corporate leaders. Often unschooled in core skills such as accounting or finance, lawyers start their careers in a strange world where risk is frowned upon, colorful marketing is unethical, people rarely work in big teams, and nobody makes a decision without reviewing stacks of paperwork first. Business attorneys are often considered the

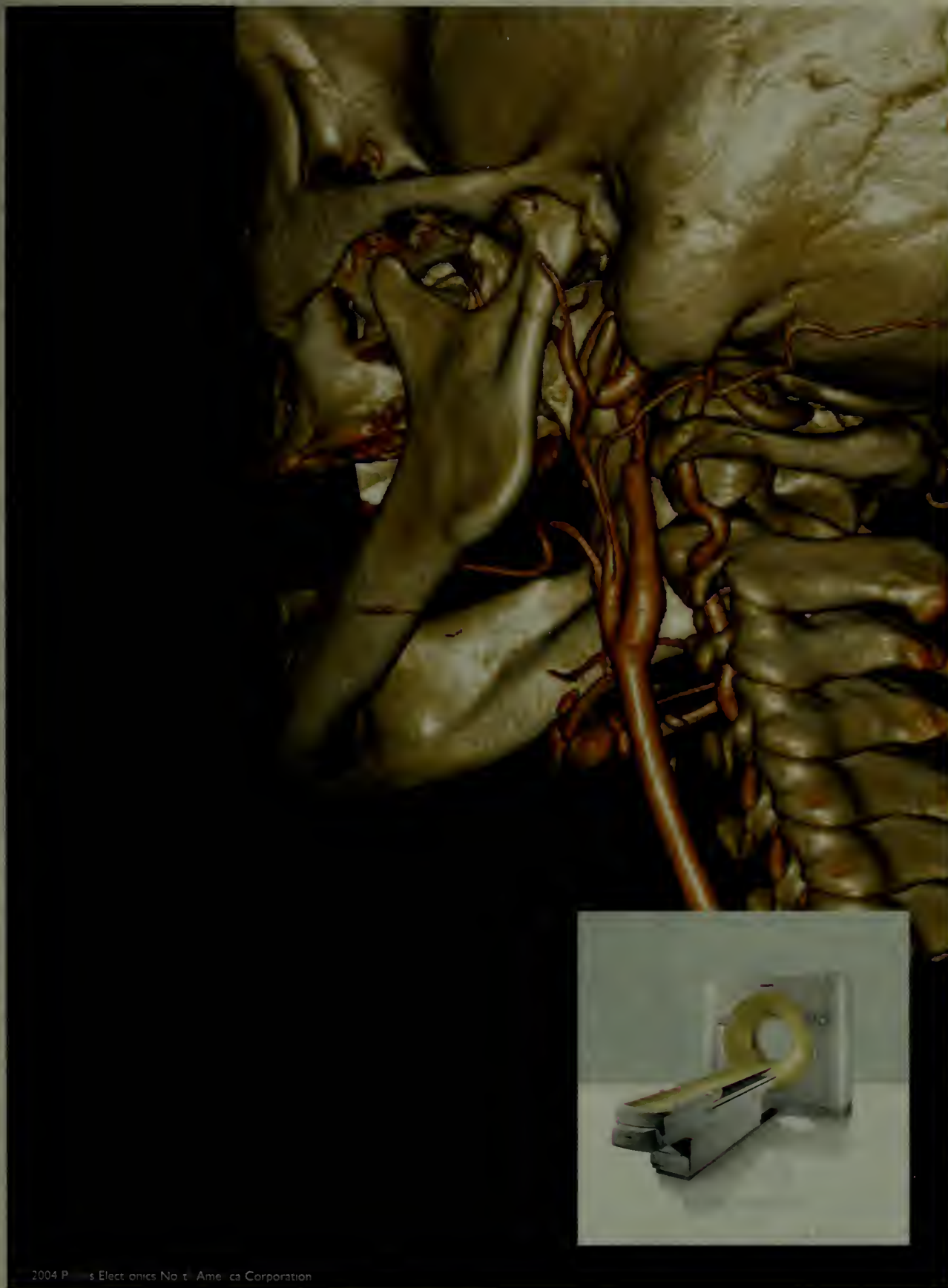
"vice-presidents of No," says Jeffrey A. Sonnenfeld, associate dean of executive programs at Yale School of Management. So it is hardly surprising that, as Sonnenfeld says, "people do ask questions when a career lawyer becomes a CEO."

There has never been

THE STAT

54

The number of CEOs in the S&P 500 with law degrees



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any systematic study analyzing how lawyers do in the corner office. But anecdotal evidence indicates that the stereotypes aren't entirely justified. For every corporate attorney who has bombed as a CEO—the most often cited example is former Time Warner chief-tain Gerald M. Levin—there has been a seemingly equal number of successes, such as Viacom's Redstone and Southwest Airlines' ex-CEO and current board Chairman Herbert D. Kelleher.

This shouldn't come as a surprise. Law schools, after all, are a rich source of intelligent and driven people. Moreover, the attorney-CEOs interviewed by *BusinessWeek* also believe that they gained a useful set of analytic skills in their journey from torts class to the courtroom. These include the ability to mediate disputes, see both sides of complex issues, and cut self-satisfied experts down to size. "A lawyer who comes in and asks basic questions about first principles can be more strategically creative in times of great change" than people grounded in a particular industry's culture, says ex-antitrust litigator Michael J. Critelli, now CEO of office equipment manufacturer Pitney Bowes Inc.

OVERACHIEVERS

THERE WAS A TIME in the first half of the 20th century, before the proliferation of MBA programs, when law school was a common path for corporate leaders. Since then, attorney-CEOs have been concentrated in heavily regulated industries—or to put it another way, in businesses in which legal issues have a greater effect on profits than, say, marketing or operations. Think utilities (Exelon's John W. Rowe, Dominion Resources' Thomas E. Capps, and many others); airlines (Southwest's Kelleher); and financial services (Fannie Mae's Raines).

When lawyer-CEOs emerge outside classic red-tape industries, they tend to be brilliant overachievers who would rise to the top of the heap no matter what their educational background. Bored with their legal practices, envious of the enormous paychecks earned by their corporate bosses, they seek out new adventures in the executive suite. "Lawyers are basically [just] advisers," says Time Warner CEO Parsons. "At the end of the day, we all want to drive the boat."

One challenge that confronts most

They're Everywhere

Lawyer-CEOs can be found in all sectors of Corporate America. A sampling:

AIG Maurice R. "Hank" Greenberg
American Express Kenneth I. Chenault
ASTAR (DHL) John Dasburg
Citigroup Charles O. Prince III
Exelon John W. Rowe
Fannie Mae Franklin D. Raines
General Dynamics Nicholas D. Chabreja
Marsh & McLennan Michael G. Cherkasky
Phelps Dodge J. Steven Whisler
Pitney Bowes Michael J. Critelli
Time Warner Richard D. Parsons
Viacom Sumner M. Redstone

Data: BusinessWeek

lawyers when they cross over to the business side is their lack of financial expertise. Some learn how to work with numbers on the job. Others get specialized training. Curtis H. Barnette, who joined Bethlehem Steel Corp.'s legal department in 1967 and served as chief executive from 1992 to 1999, spent two summers in the 1970s taking accounting classes at Harvard Business School. In the case of American Electric Power Co. CEO Michael G. Morris, a chief accounting officer at a company where he worked several years ago "really took the time to help me understand it all," he recalls. "It was like a tutorial."

Of course, finance and accounting can be learned. What's sometimes harder is the unlearning process: the challenge of transcending the work habits absorbed during a career in the law. Most top lawyers are essentially solo artists. The most famous litigators and mergers-and-acquisitions lawyers in America rarely lead teams of more than a dozen or so

people. They are paid primarily for their advice—not for their ability to motivate others. They rarely face the type of quarterly and annual production targets that define the life of a corporate executive. "I had an adaptation process," recalls Pitney Bowes's Critelli. "I appeared to some of [the company's managers] to be very disorganized when I took over."

Risk aversion can be another problem. People who go to law school rather than

B-school tend to be more cautious. After all, they're choosing a career that holds out the prospect of guaranteed good income—rather than a small chance of a spectacular one. What's more, the main goal of business lawyers is not to maximize profits but to minimize danger. "Good CEOs have to be able to make tough, bold decisions in the face of uncertainty—and that's hard for lawyers," says James Gaither, a former corporate attorney who is a managing director at the Silicon Valley venture capital firm Sutter Hill Ventures. "Lawyers want to keep working until they find the perfect answer."

But a legal background does have some compensating virtues. The most important one, these days, is that it trains people to think about hot-button issues such as corporate governance and the social

responsibilities of big companies. As a CEO, "your constituents today are stockholders, employees, customers, and the public generally," says ex-Bethlehem CEO Barnette. "Dealing with the press, dealing with Congressional committees... all of these external affairs issues are things the law prepares you for."

And of course, when a corporation finds itself in boiling water, then there's nothing like a lawyer to turn down the regulatory heat. In these days of corporate scandal, the arrival of Citi's Prince and Marsh's Cherkasky could herald a new species of lawyer-CEO: the credibility builder. Both men have been charged with creating new cultures inside their companies—which involves erecting Chinese Walls, revamping ethical codes, and generally upgrading internal policing. This all plays to the core competence of business attorneys. "Lawyers are very structure-oriented, and that's what governance is all about—changing behavior by changing corporate structure," says Charles M. Elson, director of the John I. Weinberg Center for Corporate Governance at the University of Delaware.

The number of lawyer-CEOs is only likely to grow, so long as New York AG Spitzer and his ilk continue cracking down on Corporate America. But scandals will ultimately take the legal profession only so far. While lawyers can make fine CEOs, they also come with plenty of baggage. Bottom line: Don't look for the JD degree to replace the MBA as the credential of choice any time soon. ■

—By Mike France, with Louis Lavelle in New York



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On the Firing Line At Embattled Merck

With claims against Vioxx mounting, Ken Frazier is in for the fight of his career

MERCK & CO. GENERAL counsel Kenneth C. Frazier isn't scared off by tough odds. In 1991, when he was a partner at Philadelphia law firm Drinker Biddle & Reath LLP, Frazier and two colleagues took on the case of James Willie "Bo" Cochran, an Alabama man on death row for allegedly committing a 1976

murder. Frazier believed Cochran hadn't received a fair trial because African Americans were underrepresented on the juries that heard his case. Frazier and his team, working on a pro bono basis, won a new trial for Cochran, who was acquitted in 1997. "I thought: 'I finally got somebody who will help me,'" says Cochran of his first meeting with the aggressive Frazier and his colleagues.

As much of an uphill battle as

Cochran's case proved to be, it was nothing compared to the challenge Frazier faces now. The 49-year-old lawyer will lead Merck's defense against a mounting avalanche of lawsuits surrounding painkiller Vioxx. Merck yanked the drug off the market in September after a company study confirmed it raised the risk of heart attack and stroke. If Frazier has a soft spot for the underdog, he certainly has a doozy on his hands now. "This will be the most significant challenge I've ever faced," Frazier says, adding that he's confident in the legal team he leads.

AFFAIRS OF THE HEART

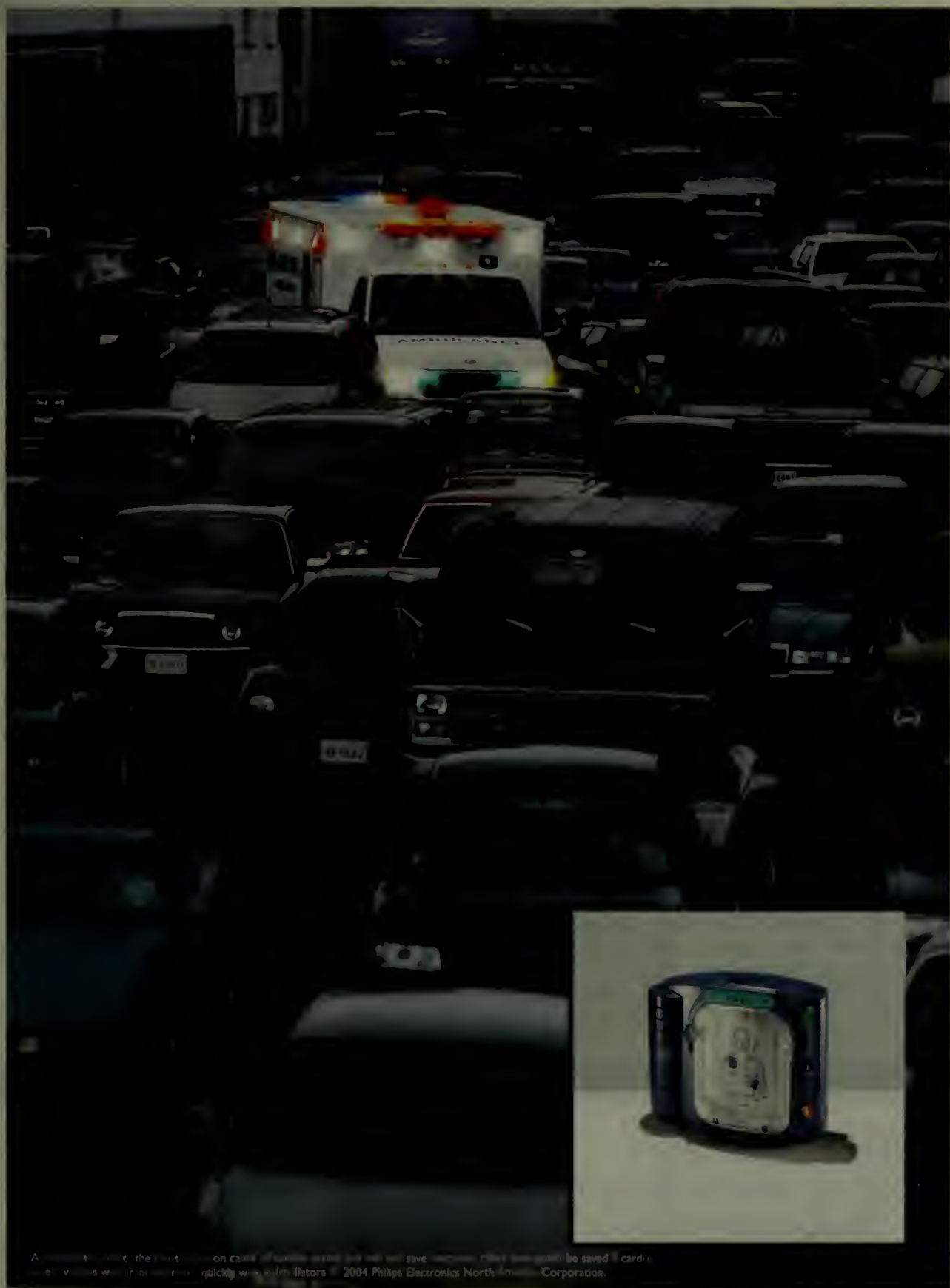
CONCERNS ABOUT VIOXX surfaced in 2000, when a study showed the risk of heart attack was higher in patients taking the drug than in those who took an old painkiller called naproxen. Merck scientists argued that the difference was that naproxen protected the heart, not that Vioxx harmed it. Yet Merck had an unpublished study showing an increased risk of cardiovascular problems with Vioxx. Without proof, critics say, that the company was downplaying the risks. Merck says regulators had data on that study, which Frazier

contends were not statistically significant. Still, Merck continued to market Vioxx aggressively to consumers, racking up \$2.5 billion in sales in 2003.

Now, Merck's future is in question. The bill for settling Vioxx lawsuits could run as high as \$18 billion, Merck Lynch & Co. estimates. And a Justice Dept. investigation finds criminal wrongdoing, the cost could be even higher. Merck's stock has plunged 38%, to \$28, since September. And corporate governance experts slam Merck's board for its recent approval of golden parachutes for the top 230 managers, including Frazier. The lawyer's ability to lessen the damage from Vioxx will help determine whether Merck is left with enough capital to regain its status as an innovative drugmaker or if it will be nothing more than an also

BRING 'EM ON Frazier is no stranger to high-profile cases





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People In The Hot Seat

ran waiting to be snapped up by a stronger player.

Frazier has an ambitious plan for fighting the coming wave of claims. He says Merck will vigorously argue that the recent study only showed an increased risk of cardiovascular problems after 18 months of continuous Vioxx use. Furthermore, he says, many taking the drug may have had other risk factors for heart attack or stroke, including obesity or smoking habits. "They are going to have to produce [medical evidence] to exclude those other potential causative factors," Frazier insists. "And I don't think that is easy to do."

Frazier will also fight to prevent the cases from being consolidated in a class action—preferring instead to take each one on separately. Legal experts say he's probably betting the company can settle the most troubling cases first and then bring a few cases to trial that it has a good shot at winning. If it does indeed win them, that might discourage other lawyers from going ahead with their claims.

UNASSUMING ROOTS

MERCK'S APPROACH IS fraught with peril, though. Some attorneys say juries might scoff at its argument that it's not responsible for heart damage in people who had other risk factors. In addition, Dr. Eric J. Topol, chairman of cardiovascular medicine at the Cleveland Clinic and a longtime Vioxx critic, calls Merck's argument that the increased cardiac risk only surfaces after 18 months on Vioxx "indefensible." He points out that the trial comparing Vioxx to naproxen showed a

difference in heart attack rates starting after just one month of use. If any early cases go against Merck, trial lawyers will be emboldened to drive the cost of settling future cases through the roof.

Although he has kept a low profile, Frazier is no stranger to high-profile cases.

Frazier wants to stop the Vioxx cases from becoming a class action

During his 14 years as a litigator and then partner at Drinker Biddle & Reath, he represented companies such as AlliedSignal and Lorillard Tobacco Co. in asbestos claims. He also handled a number of cases for Merck. One of the toughest was brought by the family of a girl who developed a fatal neurological disease after being injected with Merck's vaccine for measles, mumps,

and rubella. Frazier won the case by arguing that Merck had contracted to provide the vaccine to the Centers for Disease Control & Prevention, which in turn was responsible for warning the public about its risks. Frazier's success in such cases prompted Merck to hire him as general counsel at its Astra Merck joint venture in 1992. He joined Merck in 1994.

Frazier's rise to the upper ranks at Merck belies his unassuming roots. His father, the son of a sharecropper, moved to Philadelphia as a teen with the equivalent of a third-grade education. Frazier's mother died when he was 12, leaving his dad to raise three children alone in a rough North Philadelphia neighborhood on a modest salary from United Parcel Service, where he worked as a janitor. Frazier's father set lofty goals for his children, insisting they study hard and strive for excellence. "His view of what was possible was uncon-

strained by the circumstances we lived in," says Frazier, who once raised pocket money during college by catching newts and tadpoles and selling them to a local aquarium store. "We were raised to think we could do anything."

FUN-LOVING STREAK

THROUGHOUT THE VIOXX battle, Frazier will rely on his trademark intensity and relentlessness. Colleagues describe him as a high-energy manager who has tough time sitting still. Shortly after joining Astra Merck, Frazier felt meetings lasted too long. When his supervisor noted that Frazier seemed fidgety in the meetings, Frazier suggested they get rid of the chairs in the conference room to speed the meetings along. The demanding lawyer has a fun-loving streak, too; he often trolls the halls to chat with his colleagues about sports. And in his spare time, Frazier, who is married with two children, volunteers for organizations that serve the underprivileged. In the late 1990s he helped run the Cornerstone Christian Academy, an inner-city Philadelphia school that was racked with financial trouble and staff turnover. "Kenny was instrumental in saving the school," says Drinker Chairman and Cornerstone co-founder Jim Sweet.

Some who have worked with Frazier speculate the lawyer will eventually abandon corporate life to devote himself to his favorite social causes. Frazier says he wouldn't dream of leaving anything soon. "I'm committed to seeing this through," he says of the Vioxx cases. How he handles the Vioxx morass will surely determine how long Merck remains on the critical list. ■

—By Amy Barrett in Whitehouse Station, N.J.

BIO BOX

Kenneth C. Frazier

Bucking the odds is an old story for this seasoned attorney



BORN Dec. 17, 1954, Philadelphia.

CURRENT POSITION General counsel, Merck & Co., since 1999. Now crafting Merck's strategy for fighting the wave of lawsuits over its painkiller Vioxx, which has been linked to heart trouble.

CAREER PATH Practiced at law firm Drinker Biddle & Reath from 1978 to 1992, ending as a partner. Served as general counsel of the Astra Merck

joint venture. Started at Merck as vice-president of public affairs in 1994.

EDUCATION BA, political science, Pennsylvania State University, 1975; JD, Harvard Law School, 1978.

ROLE MODEL His father, a sharecropper's son from South Carolina with a third-grade education. His father's firm hand and big dreams for his children "provided a counterweight to what went on in the

streets" of their rough North Philadelphia neighborhood.

BONA FIDES Frazier led a team of lawyers, working on a pro bono basis, who successfully waged a six-year fight to free James Willie "Bo" Cochran, an Alabama man wrongfully convicted and sentenced to death for the 1976 murder of a store manager.

FAMILY Married for 19 years to Andréa; a daughter, 15, a son, 9.





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THE RELIEF AT HEWLETT-PACKARD CO.'S PALO ALTO HEAD-quarters was palpable. On Nov. 16, just 96 days removed from its biggest quarterly earnings miss in more than a decade, HP staffers celebrated the company's 2004 fourth-quarter results. The 66-year-old technology giant had rebounded nicely, notching a 27% hike in profits, to \$1.1 billion, while sales jumped 8%, to \$21.4 billion. The market whooped it up, and HP's stock rose a solid 8% from its 19.68 close in after-hours trading.

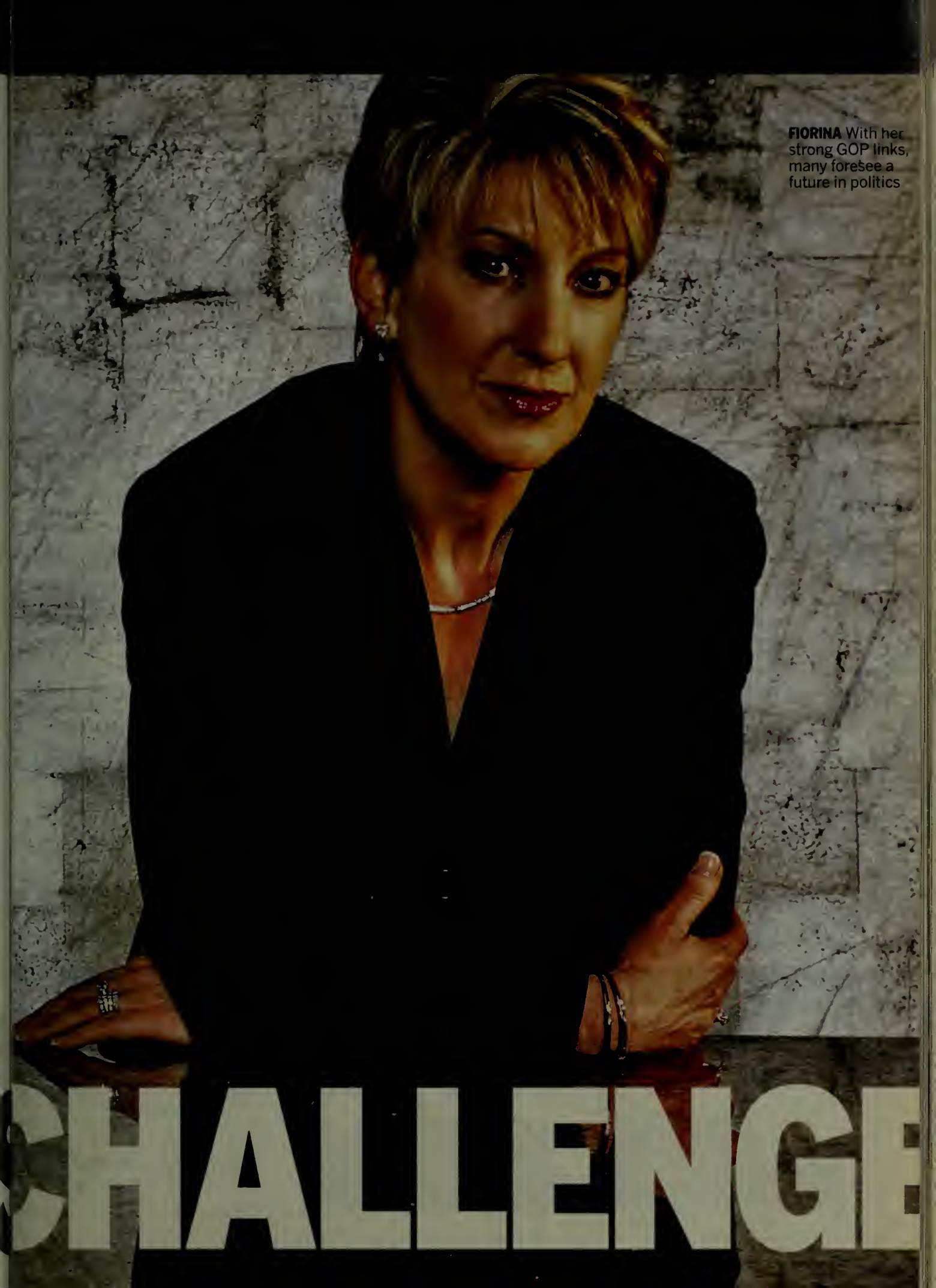
But the next day, cheers gave way to sighs. Certainly the company picked up its performance from the disastrous third quarter. But investors were quick to probe the vulnerabilities behind the cheery numbers. They noted that HP continued to lean heavily on its superstar printing business while its mammoth PC and server businesses struggled to eke out profits. More unsettling, much of the profit growth stemmed from cuts in research and development, and from a lower tax rate. Without these savings, HP's profits would have climbed only 10%—not 27%. Analyst Laura Conigliaro of Goldman, Sachs & Co. wrote in a Nov. 17 research report that HP's results were “probably not quite as good as they seem on the surface.” By the end of the day, all that HP stock had to show for its celebratory quarter was a measly bump of 52¢.

It has been more than five years since Carleton S. Fiorina hit town with bold plans to reinvent the Silicon Valley icon, and she's still struggling to put the company on the right track. The charismatic chief executive with the million-dollar smile has zealously pursued a bigger-is-better strategy, with hopes of creating a technology world-beater. Thanks largely to its \$19 billion acquisition of Compaq Computer in 2002, HP has doubled its sales in the past five years and become a competitor in an un-

GREGORY HEISLER

Hewlett-Packard still needs to prove it can execute its broad strategy. If not, pressure will build to break up this Silicon Valley icon. BY BEN ELGIN

CARLY'S



FIORINA With her strong GOP links, many foresee a future in politics

CHALLENGE



JOSHI Critics call for a spin-off of his lucrative printing and imaging division

rivaled number of markets, from \$100 digital cameras to billion-dollar tech-services deals.

Yet in too many of the businesses, HP is losing steam. Sure, its one champion, the \$24 billion printing division, gushes profits. But look beyond that crown jewel, and the rest of HP is an underachiever. In personal computers, it's no match for Dell. And HP is too often outgunned by IBM in the global markets for corporate computing. Worse, Fiorina's team faces steep operational challenges as it tries to come to grips with HP's huge stable of businesses. "It requires entirely different strategies to compete with Dell and IBM," says analyst Bill Shope of J.P. Morgan. "Judging by HP's performance, they haven't been able to do either."

Little surprise then that investors spurn HP's stock. Most analysts peg the stand-alone value of its high-flying printing business as slightly less than the entire company's \$61 billion market capitalization. That means that the rest of HP's businesses, which generate \$56 billion in revenues, are being valued at next to nothing. "We own this stock for the printer business," says Brian Bruce, head of equity at PanAgora Asset Management Inc., which holds about 2 million HP shares. "It's not clear HP has gotten the synergies they expected from the other businesses."

Despite the laments, HP is hardly teetering on the edge of an abyss. Its 2005 profits are expected to reach \$4.5 billion, with sales climbing 6%, to \$85 billion—not bad for a technology colossus. Trouble is, HP has earned a reputation for coming up short. Over the past 20 quarters, HP has missed analysts' profit estimates seven times, according to Thomson First Call. Although this is an improvement over its previous 20 quarters, that record still represents twice as many misses as Dell and IBM combined during the same period. "[HP is] trying to do 100 things. It's hard to do everything well," says Jose Tucci, chief executive of EMC Corp., a rival in the storage business.

Can Fiorina finally drive HP to realize vast potential? *BusinessWeek* has interviewed more than 100 people, including past and present HP employees, investors, customer partners, and competitors, to explore the issues and potential solutions. Suggestions abound. Some call for Fiorina to hire an operations ace to manage the company's flung divisions and get them working in sync. Others call for the company's PC di-

sion to retreat from its global network of retail distributors and to ape Dell's super-efficient direct-sales model. And many opine that HP should gobble up software and tech-services companies to better compete against IBM. The risk? If the company adds to its portfolio without first tackling the operational issues, the already daunting complexity could multiply. "Carly has to prove she can execute and it just hasn't happened yet," says a former HP vice-president who left earlier this year. That view is widely shared by many others interviewed by *BusinessWeek*.

HP acknowledges the need for more financial consistency. However the company points out that since the merger, its cumulative quarterly sales and profits are slightly ahead of cumulative analyst estimates.

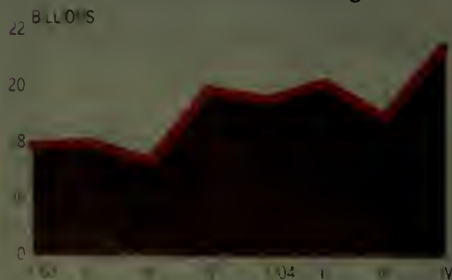
Louder Drumbeat

INVESTORS AREN'T IMPRESSED, and the drumbeat on Wall Street is growing for a far simpler solution: break the company up. The CEO staunchly resists the idea. The board continues to discuss such a move, say former and current insiders, but

THE VALUE TRAP

Despite improving financials, Hewlett-Packard's stock is lagging far behind its major rivals

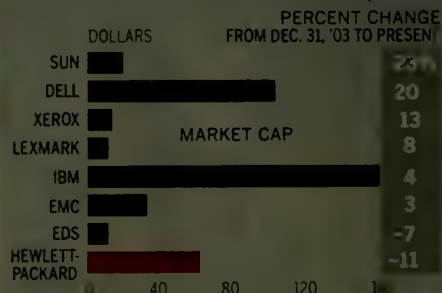
Revenues are climbing...



Data: Home - 100 g - 100 g - Markets

...and net income is rising...

...but HP's stock trails its competitors



ectors support Fiorina's commitment to hold the company together. While Fiorina declined several requests for interviews for this story, she has said in numerous public statements that such a move "destroys shareholder value." Still, the calls to split apart the consumer and corporate businesses, or to sell off the printer division, are bound to grow and spread if she fails to light a fire under HP's underperformers.

The breakup options could certainly appeal to beleaguered investors. One of the most vocal proponents of a sell-off, analyst even Milunovich of Merrill Lynch & Co., calculates that the total value of HP's businesses could increase by 25% to 45% if were split into printing and nonprinting operations. The idea that the printing business, which would probably retain the HP name, could expand its market and partner with HP's com-

puting rivals, including IBM and Dell—once it was unhitched from the computer company.

And managers of the computing company, with its divisions in software, PCs, servers, and tech services, would have to beaver away madly to make profits. No longer subsidized by the printer division, they would have no choice but to perform. Merrill calculates that the spin-off would create \$15 billion to \$27 billion in incremental value. Those numbers get shareholders' attention. "I would like them to spin off the printer business," says Kenneth A. Smith, senior portfolio manager at Munder Capital Management, which owns about 2.9 million HP shares.

For now, Fiorina continues to bank on bulk. She contends that HP's breadth pays off in added sales and lower costs. Consumers and corporations, for example, often shop for both

THE PROBLEMS HP FACES

During her five years as CEO, Fiorina has taken dramatic steps to remake Hewlett-Packard, including a 2002 deal to acquire Compaq. While the merger went smoothly, it didn't solve too many of HP's strategic challenges.

PRINTERS

The printing and imaging business is the company's crown jewel. The unit generated \$3.8 billion in operating profits in 2004, accounting for 76% of the company's operating profits. Most of that money comes from selling high-margin ink cartridges.

PROSPECTS GOOD

The \$1 billion invested in printing R&D has kept it ahead of rivals. Dell has grabbed 13% of the U.S. inkjet market, but any potential impact on profits is years off.

76%

Contribution of printing business to operating margins

FINANCIAL TARGETS

Fiorina did a strong job of cutting costs after the Compaq merger. Instead of the \$2.5 billion target, she trimmed \$3.5 billion in annual costs. She also turned in solid revenue growth of 9% for 2004. But HP has yet to hit the 8%-to-10% operating-margin targets laid out at the time of the Compaq deal. Operating margins for 2004 were 5.3%.

PROSPECTS FAIR

The revenue growth was impressive, matching IBM's performance. Still, with lagging profits in its PC and enterprise businesses, HP will struggle to hit the 8%-to-10% margin target.

\$3.5*

The total annual cost savings after the Compaq merger

WALL STREET REPUTATION

HP's inconsistency has taken a toll on its stock price. The company's shares trade just shy of the level that analysts say the printer business is worth all on its own. Fiorina has improved HP's record of meeting Wall Street's expectations. But she still has missed analyst forecasts in seven of the past 20 quarters, trailing the track records of major rivals.

PROSPECTS FAIR

Fiorina's solid fourth quarter certainly helped the process of repairing relations with investors. Now, she needs to build on that trust one quarter at time.

7

Number of times HP has missed Wall Street forecasts—out of 20 quarters

CORPORATE COMPUTING

The Compaq merger helped HP vault to No. 1 in storage and No. 2 in servers while becoming stronger in tech services. In the fourth quarter the corporate unit's sales rose a surprising 10%. Still, HP is struggling with profitability at the same time IBM and others are reaping strong profits. Even with HP's top-line gains, the margins and profits declined.

PROSPECTS POOR

Dell is squeezing HP on price in the low-end server market, while IBM is having more success winning lucrative deals for strategic services. Analysts expect a software acquisition to boost profits.

1.1%

Operating margin for storage and servers in 2004

PCs

Combining the market shares of HP and Compaq was designed to create a market leader that could slow Dell's advance. But Dell has blown past the combined HP in market share and has widened its lead, to 18.3%, of the market, vs. HP's 15.7%. HP has also fallen short of its 3% operating margin goal, reporting margins of less than 1% for 2004.

PROSPECTS POOR

Analysts don't expect HP to improve its profitability substantially anytime soon, because it can't match Dell's efficient direct-sales approach.

0.9%

Operating margin in PC business in 2004

printers and computers at the same time. So selling one fuels sales of the other. And HP does reap cost savings from its scale. After the Compaq merger, the company wrung \$3.5 billion in annual expenses out of its operations, in part by squeezing components suppliers for lower prices.

Bucking calls for a spin-off has paid dividends for technology titans in the past. That formula certainly worked for IBM. In the mid '90s, legions of analysts, eager to unlock value inside Big Blue, urged IBM CEO Louis V. Gerstner to sell off the company's mainframe division. But Gerstner resisted their calls. Instead, he plowed cash flow from mainframes into growth businesses for IBM, including the Internet. Taking a page from his book, Fiorina could attempt to patch the soft spots in her computing arsenal with proceeds from the printer business.

Broad Reach

FIORINA INSISTS THAT HP needs the broadest reach possible to capitalize on her vision of technology's future. A long-time executive at telecom giant AT&T and later at its spin-off, Lucent Technologies, Fiorina has become a leading evangelist for the converged digital world. In passionate speeches, she describes how the continuing Information Revolution will transform corporations and electrify entertainment, with the whole world becoming "digital and mobile and virtual and personal." And she has assembled a giant corporation vast enough to hawk its wares on nearly every path and byway of the digital universe. Far broader than Dell or IBM, HP spans consumer and corporate markets. It makes everything from calculators and cameras to supercomputers, and competes with Sony, Canon, Samsung, EDS, just about everyone in tech. "We think we have a unique opportunity," Fiorina said during a speech in August, "because we have leadership positions and intellectual property at every stage of the value chain."

Indeed, rather than break apart HP's existing businesses, Fiorina may look to beef them up. Even as she accelerates the cost-cutting measures, including new layoffs, another sub-



ROLLINS The Dell CEO said Dell was drawn into printers by the "profit pool" of competitors

ing into politics at some point. Her public support of President George W. Bush and her work on California Governor Arnold Schwarzenegger's transition team have led to open speculation inside HP that Fiorina is positioning herself for an Administration appointment or a run for the U.S. Senate—perhaps a 2006 race against Democratic Senator Dianne Feinstein. She demonstrated her political skills by pushing through the Compaq acquisition, the largest deal in computer history, over fervent and well-funded opposition. And her quick integration of the two companies exceeded even the expectations of her supporters. But if her turnaround at HP continues to stall, her political prospects could grow dimmer by the quarter. Fiorina would not discuss her political ambitions with *BusinessWeek*, but at a November meeting with her senior staffers she addressed the swirling rumors and promised to stay at HP.

Fiorina carries the solid fourth-quarter results into a widely anticipated analysts' day in Boston on Dec. 7. This eases the pressure for her to take dramatic action. But as Goldman's Conigliaro suggests, the latest numbers merit a second look. During the period, HP's tax rate fell to 15%, down from 19% a year earlier. In addition, research and development fell to 4% of sales down from 4.6% the year before. This pumped up profits. Investors who are excited about a sustained, profitable growth spurt from HP should be wary. "You can't simply keep cutting R&D and the tax rate to boost profits," says analyst Richard Chu of SG Cowen Securities Corp.

HP acknowledges the point. Robert P. Wayman, the company's chief financial officer, said in a Nov. 16 conference call with investors that the decline in the tax rate was primarily result of the favorable resolution of a state tax audit and that the tax rate would probably rise to 20% in the coming year. HP officials have said in the past that they expect R&D spending to decline, because of the elimination of redundancies from

{ INSTEAD OF BREAKING APART HP'S EXISTING BUSINESSES, FIORINA MAY LOOK TO BEEF THEM UP—THROUGH ACQUISITIONS

stantial acquisition remains a possibility, particularly in software or services. Several former and current insiders say HP pondered a deal for Veritas Software Corp., a leader in storage, although it is not clear if any discussions ensued. Another target, say analysts, could be Capgemini's U.S. operations, which the struggling French consultancy is said to be shopping around. Capgemini, however, denies its U.S. operations are for sale. Veritas declined to comment. HP has said it would not rule out additional acquisitions.

Pulling all of this off could be as critical to Fiorina as it is to HP. The 50-year-old chief executive has told colleagues who were interviewed by *BusinessWeek* that she is interested in go-



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the Compaq merger and its efforts to place fewer, more focused research bets.

As analysts comb through HP's fourth-quarter numbers, other questions arise. During the period, the amount of money that HP was owed for its products—the accounts receivable—surged by \$1.8 billion, to \$10.2 billion. That caused the amount of HP equipment that retailers and other partners have in stock, but haven't paid for yet, to climb in October to the equivalent of 43 days of sales, up from 40 days in the previous quarter. It's the highest level since 2002. Some experts suggest that this may be a sign that HP is burnishing its results. "[It raises] questions about end-of-quarter sales, particularly into the channel," wrote Goldman's Conigliaro in her Nov. 17 report. HP defends the increase, however, saying that it shipped extra units to support several product launches.

Unwieldy System

STILL, HP SUFFERS FROM poor positioning. In its PC business, HP runs two systems that often operate at odds with each other. One is a direct-sales, build-to-order model to compete with Dell, which carries virtually no inventory. The other is HP's traditional, higher-inventory model for units that it ships through its sales partners. Operating in both worlds leaves HP doubly exposed. It fails to match Dell's scale and efficiency in the direct system.

Yet if the company pushes more business into direct sales, it risks angering thousands of HP's traditional retailers and resellers. And HP needs their help to sell its printers and ink. A break-up would help to resolve this dilemma, freeing the computer division to adopt the Dell approach. For now, though, HP keeps both systems intact—and in the process loses ground in PCs. Following the Compaq merger, HP briefly rose to the No. 1

in PCs. But the company has slipped to No. 2, with 15.7% share behind Dell, which has an 18.3% share. Operating margins in 2004 were a meager 0.9%, miles behind Dell's 8.8% margins.

HP also appears overmatched in its scrum with IBM. Led by CEO Samuel J. Palmisano, Big Blue has put together a more lucrative array of corporate computing products. They span everything from software to servers to chips, and they generate overall 11% operating margins. By comparison, HP's non-printing businesses managed operating margins of 3% in 2004. The



HP IS STRUGGLING AGAINST DELL IN THE PC BUSINESS. AND IT'S OVERSHADOWED BY IBM IN HIGH-END CORPORATE COMPUTING

disparity is especially clear in the profit-rich software business. In IBM's third quarter, ended in September, its software business generated \$3.6 billion and operating margins of 25%. HP, by contrast, notched \$277 million in software sales for its fourth quarter, ended in October, posting a small operating loss.

At times, HP's push for synergies has gotten in the way, satisfying customers and insiders. Take storage. After buying Compaq's market-leading storage unit, HP integrated it into its enterprise group, which also includes servers and software. Along the way, HP laid off scores of storage-sales specialists in favor of sales reps with a broad knowledge of HP offerings. Key storage executives followed them out the door. In short order, competitors such as EMC Corp. began to nab customers from HP. Storage revenue dropped 5% in 2003 and a further 7% in 2004. Even loyal HP

HOW TO UNLOCK HP'S VALUE

Even after a surprisingly strong fourth quarter, HP's stock is trailing the competition. Here are the major options for boosting the company's value:

1

STAY THE COURSE

Fiorina could stick to her bigger-is-better strategy and concentrate on improving execution. If she puts together a string of strong quarters, she'll get a stock boost for reliability. But this may be the toughest option. No tech company rivals HP's breadth in products, geographies, and avenues to market. To accomplish this, Fiorina will probably have to hire a chief operating officer, despite her past reservations.

2

DOUBLE DOWN

HP could decide to get even bigger through another large acquisition. A large tech-services company, such as the U.S. operations of Capgemini, is possible. Indeed, HP was in talks to acquire PricewaterhouseCoopers Consulting in 2000, before the deal fell apart over price and IBM bought it. More likely, HP would pursue a corporate software company, such as Veritas or Mercury. The risk is that HP will become even more complex, increasing Fiorina's management challenge.

3

THE BIG BREAK-UP

Because many on Wall Street view HP as an unwieldy conglomerate, its market cap is \$61 billion, a big discount from the estimated value of the individual businesses. That has some analysts agitating to split off the printing business, estimated to be worth as much as \$60 billion. The rest of the company is being valued at close to nothing now, despite its \$56 billion in sales. Without the printer business, analysts say the computer-related operations could be worth about \$20 billion.

A woman with dark hair, wearing a pink button-down shirt, is leaning over and talking to a young child. The child is wearing a blue shirt. They are outdoors, with green foliage in the background. The scene is lit with warm, golden light, suggesting late afternoon or early morning.

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LIVERMORE The non-printing HP units she runs are struggling to boost profits

customers, such as grocery company Indoff Inc., bolted for EMC when buying storage gear earlier this year. Says Shawn Faulkingham, Indoff's chief information officer: "I was looking for bang for the buck, and HP didn't have it in this case." Although HP recognizes the error and is hiring back storage specialists, it cautions that a turnaround in storage could take time.

Other customers have even more serious complaints. For instance, HP has developed customized Web sites for customers where they can place and manage orders. However, these sites, dubbed B2B (for business-to-business) by the company, have frequently cratered—erasing accounts, losing orders, and shipping the wrong products, according to former sales managers, customers, and internal sales memorandums that were obtained by *BusinessWeek*. In one such memo, written back in February, 2004, an HP sales representative complained to his superiors about the disappearance of 70 customers from the B2B systems: "I can't even explain how many relationships... have been burned with this new site." HP has no comment on the B2B issue.

Patchwork Quilt

SIMILAR WOES HAVE hamstrung HP's efforts to take on IBM in large corporate computing deals. Eight former employees and executives, who all departed within the past year, say that the technology supporting HP's corporate-computing sales—from order administration systems to customer databases—remains a patchwork of overlapping and poorly fitting systems despite recent efforts at improvement. HP sales reps laboring within this regime spend only 30% to 35% of their working time with customers and partners, compared with 55% to 60% at well-run organizations, former sales executives say. "I would stress how difficult it is to do business inside HP," says Paul Gerrard,

HP's former vice-president for enterprise sales in the central U.S., who left the company in June and now runs sales at a tech company in Colorado. "There are terrible inefficiencies in the system."

To pull off a big sales deal at HP these days often requires delicate diplomacy. Putting together a package involving servers, printers, and software, a sales rep has to hammer out an agreement with each division. If one unit is concerned about financial targets, and unwilling to bend its price, the whole deal can fall through. The company lacks an effective process to resolve conflicts. Fiorina herself helps broker some deals, but she has time only for the biggest accounts, say former execs. "It's the tier-two deals that fall through the cracks," says a former sales vice-president.

These management tangles have fueled calls within HP for hiring a cracker-jack operations chief. Fiorina has categorically ruled out hiring a chief operating officer, saying that a strong CEO should keep a grip on operations. Yet as *BusinessWeek* previously reported, HP is quietly seeking a top manager to run all non-printing operations. Sources close to the search, including an HP insider, say that the recruitment effort is continuing. Many investors and analysts view Fiorina as an inspiring speaker and salesperson, but either lacking the skills or stretched too thin to solve HP's grinding operations challenges.

If Fiorina continues to struggle, pressure is sure to mount for her to spin off the printing and imaging division. The unit is spearheaded by Executive Vice-President Vyomesh Joshi, who spans everything from printers and ink to digital cameras. It boosted its sales by 7% in 2004, to \$24.2 billion. And it's a cash geysier, providing 76% of HP's operating profits, derived from just 30% of total sales. Investors clearly love it. Analysts speculate that freedom from broad corporate management could goose the printer group's performance. And they argue that separating from the printing division could protect HP from its most dangerous long-term threat in the printing business, Dell.

MANY VIEW FIORINA AS AN INSPIRING SPEAKER—BUT LACKING THE SKILLS OR STRETCHED TOO THIN TO FIX HP'S OPERATIONS WOES

PC juggernaut Dell got into the printer business two years ago by reselling Lexmark International Inc.'s printers under its own brand name. Since then, Dell has grabbed 13% of the U.S. inkjet market, according to researcher IDC. But why is Dell winning printers, a low-margin business for resellers? One primary reason is because HP is using the cash from its printing business to fund the computer division that competes with Dell. "There's no profit pool that some of our competitors are using to subsidize the PC and server business," Kevin B. Rollins, Dell's CEO, told *BusinessWeek* as Dell plunged into the business in 2002. "That's something we have to go after."

Although it's unlikely Dell would exit the printer business,



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HP spun off its printer operation, Dell would have much less incentive to push punishing price wars, making life easier for the stand-alone HP printing business. And conceivably rivals such as IBM and Dell could resell HP's equipment or license its technology. "If HP separated their businesses today, and the imaging and printing business was its own entity, I would bet we would be partners because they're a source of technology," says Tim Peters, vice-president for imaging and printing at Dell.

The argument for printer independence has to sound familiar to Fiorina. She was a top exec at AT&T when it decided to spin off its equipment arm in 1996. The primary reason was to enable the division to sell more gear to AT&T's competitors, including SBC Communications Inc. and BellSouth Corp. The spin-off, dubbed Lucent, initially became a high-flying success, and Fiorina basked in its glow. After 8% revenue growth in 1995, the company averaged more than 15% growth during its first three years on its own, before swooning during the telecom industry's downturn.

Going Shopping?

HP'S CORPORATE COMPUTING businesses, though far less attractive, could also benefit from standing on their own. Although investors are valuing the nonprinting operations at next to nothing now, these units, most of them run by Executive Vice-President Ann M. Livermore, generated \$1.4 billion in operating profit in 2004. Merrill Lynch's Milunovich and others figure that

the businesses, if they were independent, could be worth \$18 billion to \$21 billion. That calculation is based on applying the same operating margin multiple bestowed on IBM, minus a 20% discount, since Big Blue is considered to be better run and touts higher-end tech services. Still, Milunovich predicts that without the protection of the cash-cow printing business, managers would respond to acute pressure to revamp its sales, upgrade tech systems, and jettison flagging businesses.

{ CRITICS ONCE TOLD IBM'S GERSTNER TO BREAK UP THE COMPANY. HE DIDN'T—AND IBM PROSPERED. PERHAPS HP COULD DO LIKEWISE

Despite the execution woes, Fiorina is open to acquisition. Her best bet for boosting enterprise profits is in software. She has \$13 billion in cash—plenty to bulk up the software business much as storage hardware maker EMC has done during the past two years. Promising targets: two leaders in systems management software, Veritas and Mercury Interactive, could sweeten HP profits. In its most recent quarter, Veritas posted operating margins of 25%, compared with the 2.6% operating margins for HP's enterprise business in its fourth quarter.

HP's services division also needs a lift. With \$1.5 billion in revenues, this group helps corporate customers manage and stitch together new information systems. Yet HP struggles in services against IBM, whose service division is three times bigger. While more than 60% of HP's services business comes from low-end, slow-growing customer support and maintenance, IBM boasts richer contracts. Some 70% of Big Blue's service revenues come from business consulting and strategic outsourcing, the kinds of high-margin deals that put IBM consultants into the corner office. No single acquisition will put HP on an equal footing with Big Blue. A purchase of Capgemini's U.S. operations, valued at about \$1 billion, would give Fiorina more of a chance to compete with IBM in this arena. IBM strengthened its high-end consulting services through the \$3.5 billion purchase of PricewaterhouseCoopers Consulting in 2002—a purchase Fiorina says she nixed at a lower price.

As Fiorina completes a half-decade atop HP, the excitement of the early years has faded. The charismatic and determined CEO who set out to build a titan has now assumed a defensive posture and is working to keep her creation in one piece. For success, she must tackle HP's stubborn operational glitches. This will require every ounce of her guile, passion, and boldness. But at this point, her choices are stark: The only way to defend the sprawling HP she has built is to fix it. Unless she does, the calls for the breakup of a Silicon Valley icon will only grow louder. ■

—With John Cady in New York and
Andrew Park in Dallas



PALMISANO At IBM, his software, servers, and chips yield operating margins of 11%

BusinessWeek online For more on Hewlett-Packard's thriving printing business, go to businessweek.com/extra



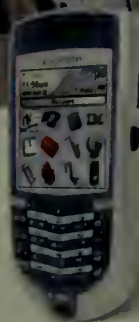
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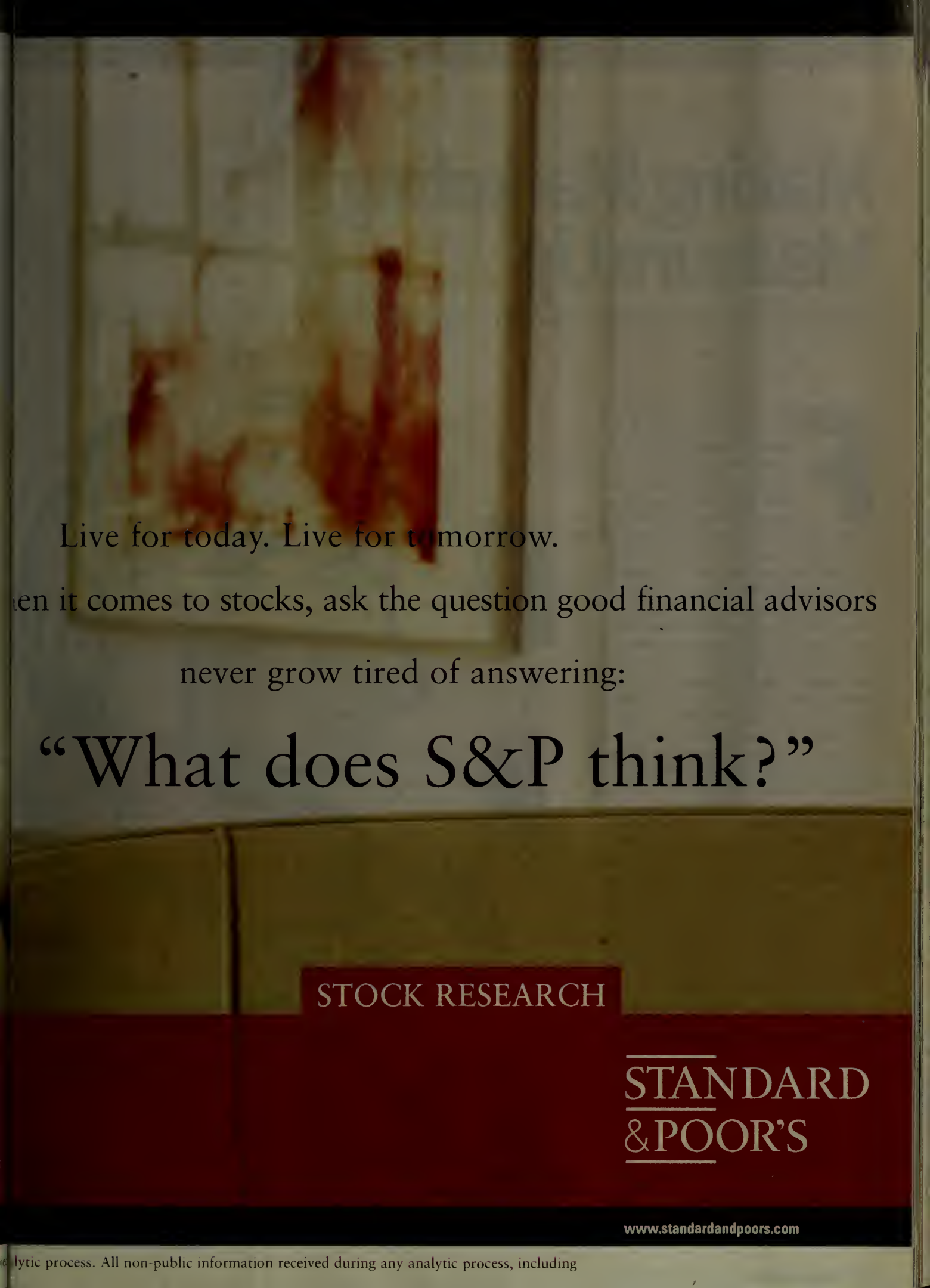
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Making Marketing Measure Up

The pressure is on to take the guesswork out of ad spending

FOR YEARS, CORPORATE marketers have walked into budget meetings like neighborhood junkies. They couldn't always justify how well they spent past hand-outs or what difference it all made. They just wanted more money—for flashy TV ads, for big-ticket events, for, you know, getting out the message and building up the brand.

But those heady days of blind budget increases are fast being replaced with a new mantra: measurement and accountability. Armed with reams of data, increasingly sophisticated tools, and growing evidence that the old tricks simply don't work, there's hardly a marketing executive today who isn't demanding a more scientific approach to help defend marketing strategies in front of the chief financial officer. Marketers want to know the actual return on investment (ROI) of each dollar. They want to know it often, not just annually. And increasingly they want a view of likely returns on future campaigns. "Marketing has gone from being a cost or expense to an investment," notes Martyn Straw, chief strategy officer of ad agency BBDO Worldwide, who says honing an ROI system for clients is his main job. "Call marketing an equity investment, and suddenly there's lots of accountability in the room."

The push is coming from the top ranks. CEOs, CFOs, and even board directors, have relentlessly cut costs in every corner of their companies except marketing and are fed up with funneling cash into TV commercials and glossy ads that they say cost more and seem to do less. That's especially true at a time when profits are under attack and consumers of all ages are zapping ads and spending more time playing video games and surfing the Internet. The bean counters know that mar-



eting matters. But they're hazy about how much or what kind.

That's one reason companies are increasingly shifting their dollars from TV and print ads to the Net and direct marketing. They can get a swift and accurate measure of the impact of their efforts for a fraction of the cost of advertising in traditional media. DaimlerChrysler, for example, is relying less on 30-second TV ads in favor of events where names, profiles, and addresses of prospects can be collected and tracked. It's also pushing direct marketing and online advertising where response rates are easily measured. "You better believe my money is chasing media and marketing outlets that can prove their return in hard data," says Jeff Bell, vice-president of Chrysler/Jeep marketing.

DASHBOARD DATA

COMPANIES IN EVERY segment of American business have become obsessed with honing the science of measuring marketing performance. Consumer-products giants such as Procter & Gamble, Kraft Foods, and Gillette are further along this path, having long chased statistics to link different forms of marketing to sales and brand awareness. But the desire to construct a comprehensive set of performance measures—what many call a marketing "dashboard"—is just extending to marketers in other industries as well. Xerox Corp. uses the measurement techniques of Six Sigma to analyze marketing's impact on a range of measures, from leads generated to cost per sale. Home Depot Inc. has a proprietary computer model with sophisticated algorithms that correlate marketing investments with product sales and regional variations that have led the retailer, for example, to push paint using radio spots in some markets and newspaper inserts

in others. "Marketing ROI is one of the most difficult things to measure in retailing because of all the details," says John Costello, executive vice-president for merchandising and marketing. But, he adds, the ability to do it right is fast becoming a competitive advantage.

For many, the goal is to identify and cultivate potential buyers—and then track whether they respond to marketing efforts by ultimately making a purchase. Mark R. LaNeve, head of North American marketing and advertising for General Motors Corp., cites customer tracking as the carmaker's top priority. "We do less and less advertising simply because it feels right," says LaNeve. There are no more sponsored golf tournaments, for example, unless the sponsoring brand collects a healthy number of customer profiles through test drives. Those people are then tracked every time GM runs into them through a similar event or mailing and again when they buy a GM vehicle. Such measures have helped GM halve Cadillac's marketing spending over the last three years while increasing sales, market share, and awareness. Although marketing giants such as GM know they have to be on TV to launch models and blitz airwaves with a new rebate deal, the share of the marketing budget going to network TV is steadily declining. LaNeve says he knows with 98% certainty what the payoff of a direct-marketing campaign will be before committing a cent. Yet the impact of image-building TV and print ads—as opposed to those pitching rebates—remains mostly "a mystery or educated guess."

The Holy Grail is to measure the impact of a 30-second TV ad

Indeed, the Holy Grail of measurement is to figure out the impact of traditional mass advertising, especially the 30-second TV commercial. One of the most elaborate efforts involves a joint venture between Arbitron Inc., a media and marketing research firm, and VNU, the Dutch media company that owns Nielsen. "Project Apollo" next year will begin tracking the media habits of 30,000 households representing 70,000 consumers. "Panelists" wear a pager-like device that picks up all the electronically coded TV and radio they consume. That data, plus online usage and grocery purchases scanned in half the households, and frequent surveys of attitudes and lifestyle choices should help advertisers figure

out which of their marketing tactics really pay. Procter & Gamble Co., which spent \$4.4 billion on advertising in the last fiscal year, has already signed on as a subscriber. P&G is looking for the system to tell it whether it's better off funding an end-aisle display in 2,000 grocery stores or increasing its radio ad buy for a month in the same markets. "It's not perfect," admits Arbitron's project head Linda Dupree. "But the information they get will be the best they have ever had."

PERFORMANCE ANXIETY

BECAUSE ADVERTISERS work with multiple ad agencies there's a push to establish some benchmarks and standards for measuring ROI. The CMO Council, a Silicon Valley network of close to 1,000 chief marketing officers at tech companies, released an extensive report of marketing performance measurements in October. Merely counting eyeballs no longer seemed enough once the tech bubble burst, says the report's editor-in-chief, William Glazier. Yet fewer than 15% of council members have a comprehensive model in place.

For all the effort to bring science to marketing, the art component will never go away. Figuring out how much of a product's appeal is due to marketing and how much stems from innovative features or quality is often hard to pin down, even for individual consumers. They don't know why they like it, they just do. That's the human factor—and so far, no one has found a way to measure that. ■

—By Diane Brady, with David Kiley and bureau reports

A Madison Avenue Makeover

Frustrated over their inability to measure the bang they get for their marketing bucks, advertisers are trying new methods of gauging advertising effectiveness:

GENERAL MOTORS	GM is shifting more dollars into "addressable" media: direct marketing, online, and events through which it can collect names, profiles, and e-mail addresses. This gives a clearer sense of which messages inspire people to actually buy a car.
PROCTER & GAMBLE	P&G is an early subscriber to Apollo, a joint Arbitron/VNU project that will track the media habits of 70,000 people. Apollo should yield ad effectiveness using that data plus home scanning of groceries, Internet usage, and frequent surveys.
HOME DEPOT	Sophisticated computer modeling matches media plans to sales. The data allow smarter, more localized spending decisions: Newspaper ads may drive paint sales in one region, for instance, while radio works better in another.

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Juniper Takes a Nip Out of Cisco

Its share gain has been Cisco's loss, and its "Infranet Initiative" has won big backers

HAD SCOTT G. KRIENS stayed at StrataCom Inc. for a few more weeks in 1996, he would have ended up working for fast-rising networking star Cisco Systems Inc., which bought StrataCom that April. But rather than take a ride on the Cisco rocketship, Kriens left to run tiny Juniper Networks Inc. Now, Kriens and Juniper are the highfliers. Over the past year, Juniper has handed its Silicon Valley neighbor a string of defeats in the market for gear used to shuttle e-mail, videos, and Internet phone calls between cities and continents. Juniper's share rose from 30% to 36% in the second quarter, while Cisco's fell from 60% to 58%, according to Infonetics Research Inc.

The main reason for Juniper's success: focus. While Cisco sells to all manner of customers, Juniper has until now concentrated on one: the telecoms. Un-

encumbered by the legacy of earlier technologies and the need to be all things to all customers, it has won a reputation as an innovator. Its routers are considered more reliable in a business where downtime is unthinkable, partly because its software has been better tuned than Cisco's to telecom's

KRIENS His goal: An Internet that's no longer one-size-fits-all

needs, according to analysts.

Now, Kriens, 47, aims to carve out a far more important role for Juniper. His goal: to help transform the Internet from a one-size-fits-all network to one that can be optimized on the fly to handle myriad tasks. Juniper is spearheading a standards-setting effort, dubbed the Infranet Initiative, aimed at steering the switch-over.

If the initiative is successful, phone and cable-TV companies will be able to offer a full range of services, from basic to fancy, at varying prices. For instance a family would be able to reserve an HDTV-quality link so a sick relative could watch a wedding online as it happens. "Juniper is trying to push the Internet forward," says Balan Nair, Qwest Communications International Inc.'s chief technology officer.

The Infranet—a contraction of infrastructure and Internet—is a coalition that brings together network-gear makers and communications companies such as America Online and BT Group with makers of online software, such as Oracle and IBM. The group plans to release technology standards in coming months that carriers can use to identify all incoming traffic—and enforce the security and speed requirements needed to handle it appropriately.

Not surprisingly, Kriens sees Juniper as best able to incorporate the new standards that fulfill his vision. By providing the smarts behind a more potent Net, "we have the chance to be every bit as influential as Intel or Oracle or Microsoft is today," says Kriens.

It's an audacious plan, and Juniper has miles to go before it can rival Cisco's might. Juniper is still small fry. Sure, its revenues grew 118% in the

The Secrets of Juniper's Success

Here's why Juniper Networks threatens networking giant Cisco:

SAVVY STRATEGY While Cisco sells mostly to corporations, Juniper is focused on phone and cable companies. This market is expected to grow 16% a year, vs. 12% for the corporate market, says Synergy Research Group.

TOP-NOTCH HARDWARE Designed to carry traffic between cities and continents, Juniper's high-priced routers are considered tops for reliability.

BETTER SOFTWARE Juniper's software has always been designed specifically for the needs of phone and cable companies. Cisco is only now starting down this path.

COMPELLING VISION CEO Kriens is spearheading what he calls an Infranet Initiative to make the Web more useful in more ways—say, to reserve supersecure bandwidth to hold an impromptu videoconference from home.

third quarter, to \$375 million. But Cisco logged revenues of \$22 billion in the year ended on July 31 and dominates markets for everything from corporate gear to home routers. Cisco Senior Vice-President Mike Volpi expects to take back some of the share the company lost once carriers finish testing Cisco's new products. As for the Infranet, he says, "the concept is not a bad one, but the vehicle should be a standards body" rather than a group started by Juniper.

SWEET SPOT

WILL, KRIENS IS IN a good position to catch a major wave. He's betting that corporations will rely more and more on telecommunications outfits to run their networks rather than handling it themselves. That puts Juniper, with its focus on telecoms, in the sweet spot for revenue growth. The carrier market is expected to grow 16% per year over the next four years, vs. 12% for the corporate market, says Synergy Research Group Inc. "This is something Cisco could have addressed—and could have," says Thomas L. Nolle, president of telecom consultant CIMI Corp. Now, he says, Cisco has to play catch-up.

Success for Juniper will require more than just a vision. That's why Kriens is pushing Juniper on a number of different fronts. To keep its edge in carrier routers, the company will unveil new technology, TX Matrix, on Dec. 6 that will allow customers to link its fastest routers and improve performance without changing models. Juniper is also expanding in new directions by selling some gear to corporations. For instance, it has begun selling lower-end "access routers," which corporations use to connect to the Internet. It's a market that Cisco dominates, so Juniper faces tough competition.

Another risk is that Juniper will lose the focus that got it where it is today. Until now, the company sold only 40 or so big carriers. To sell to thousands of companies, Juniper plans to spend \$100 million next year to crank up its sales and marketing.

How far can Juniper go? Even its execs admit it won't be able to keep gaining share on Cisco at a gallop. Still, if Kriens can manage its growing pains, Juniper will be nipping at Cisco for the foreseeable future. ■

—By Peter Burrows in
San Mateo, Calif.

The Business Of Blogging

Explosive growth means Web logs are suddenly in Madison Avenue's sights

JUST A YEAR AGO, BLOGS were viewed as a collection of off-the-cuff ramblings in cyberspace read mainly by online devotees. Then, as the election season heated up, bloggers gained new prominence, writing up-to-the-minute news and politics nuggets that the mainstream media struggled to match. Suddenly, millions of Americans were turning to political blogs such as instapundit.com and journalist Andrew Sullivan's Daily Dish. And blogs about everything from art-world gossip to macroeconomics are drawing audiences,

too. A new medium, though still a work in progress, is coming into being.

Now advertisers are realizing there is a market emerging in the blogosphere. Already, the growth in regular online advertising, estimated to be about 35% this year, will far outpace the spending increases for any other sector of the media world. Add to all this the fact that about 11% of Internet users today are inveterate blog readers, and the blogging scene starts to get mighty compelling for marketers.

Don't expect a repeat of the dot-com rush that inflated the Web bubble of the late 1990s. "This is a long game, with

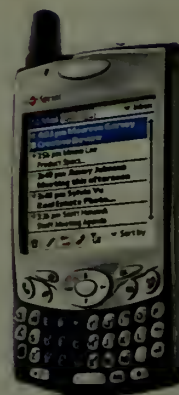


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office and checks game score.

Moves laptop from one
shoulder to other.



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Media The Internet

ts of ebbs and flows," says Henry Copeland, founder of media-buying firm LogAds. Blogging isn't about to lead to vast wealth anytime soon, says Copeland, but he does expect "more money to [flow to] more authors as smart advertisers bypass publishers and pay authors directly for their audiences." BlogAds is placing ads on 50 to 100 blogs a day for up to 20 advertisers, including Sharp Electronics Corp. and Walt Disney Co. Just six months ago, the firm served 20 blogs for about 10 advertisers.

Blogging's extraordinary growth has made all the difference. An estimated 4.8 million blogs now exist in cyberspace, up from just 100,000 two years ago, according to blog search engine Technorati. And bloggers are finding all kinds of ways to make money doing what they

A Boom in the Blogosphere

No wonder advertisers are starting to flock to blogs

GROWTH About 12,000 new Web logs are created each day, or about one every 7.4 seconds, for a total of 4.8 million blogs.

TRAFFIC About 11% of Internet users—some 50 million—are regular blog readers. A third of them post comments on the blogs.

Data: Sifry, Inc.; Pew Foundation

nce did as mere labors of love. They're signing up with independent ad distributors, striking revenue-sharing deals with large aggregators, landing direct sponsorships by corporations, and getting hired to blog for companies.

PARKING DEBATE

DEPENDING ON THE approach, bloggers can earn anywhere from a pittance to more than \$10,000 a month. One way to make a buck is to get snapped up by a few crop of blogmasters, including Nick Denton and Jason Calacanis, two thirty-something entrepreneurs who are building blog empires based on traditional publishing models. Each of them owns multiple niche blogs that employ a handful of experts. They collect and then dole out ads so their paid bloggers don't have to stress out about doing it themselves. Google's AdSense does it somewhat differently: Individual bloggers sign up, ads are delivered to their sites, and they get a share of revenue based on click-through rates.

Companies are constructing similar models to entice bloggers to come on board. American Lawyer Media (ALM) introduced a blog network to its Law.com site in late November. It links to eight independent sites covering specialized legal topics. Bloggers agree to host ads from various marketers, and in return ALM shares the advertising revenue and pays hosting fees for the blogs.

J. Craig Williams, whose blog, may-it-pleasethecourt.net, is part of the law network, says he expects his monthly traffic of 100,000 page views to rise substantially. That's because he'll get traffic from Law.com, which garners about 7.5 million page views. He says he has no idea how much he'll earn, but that "it's a nice thing to be able to say I'm being paid to blog." Yet another twist: Marqui, a communications-software maker in Vancouver, recently began paying a dozen established bloggers \$800 a month to talk about its products.

But can marketers, looking to push products online, and bloggers, treasuring their independent voices, co-exist? It won't be easy. Consider the case of car blog jalopnik.com. Audi is its exclusive sponsor, which has sparked debate in the blogging world about whether that constitutes selling out. Denton, whose Gawker Media operates jalopnik, contends that the Audi sponsorship is ethically legit, but he's also pushing for the formation of a blog ethics committee to create standards.

For its part, Audi says that its sponsorship of jalopnik.com has been a success so far. Since 85% of Audi buyers do research online before coming into a showroom, according to online marketing manager Jim Taubitz, the blog is a great tool for reaching savvy shoppers. And if jalopnik's bloggers "bad-mouth Audi?" "There's always that risk," says Taubitz, but that same risk exists in any other media outlet in which Audi advertises.

Bloggers themselves are divided about the role of ads. Calacanis insists on posting disclaimers on his 60 Weblogs Inc. sites that clearly label advertising as distinct from editorial content. But some bloggers figure they themselves bear the responsibility to act ethically. "I must rely on my own judgment and what is the right and the wrong thing to do," says Mitch Radcliffe, a writer in Washington who has signed up with software maker Marqui.

Clearly, the business of blogs is in its infancy, with lots to be worked out. But that's not stopping marketers, entrepreneurs, and writers alike from diving into this newest form of New Media. ■

—By Lauren Gard in New York

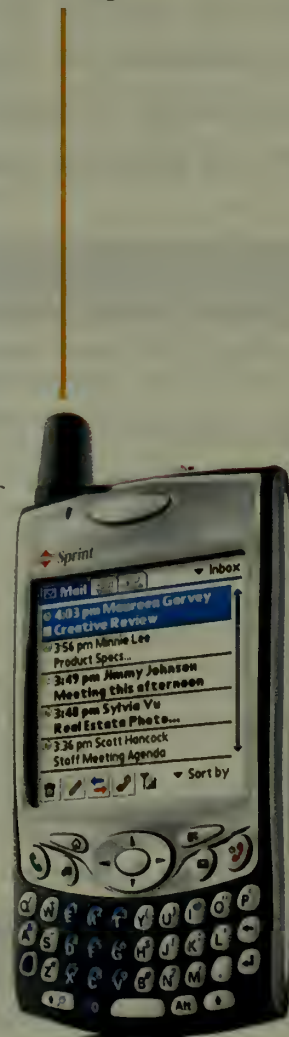
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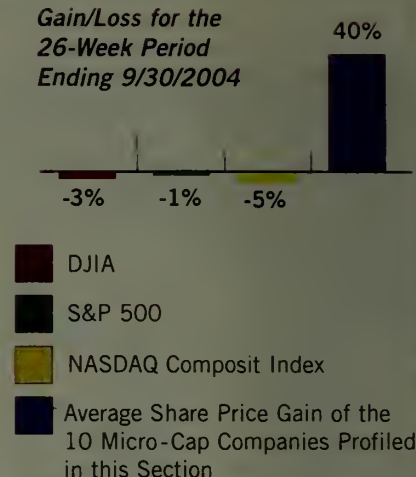


THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING MICRO-CAP COMPANIES AS OF 9/30/04

From the approximate 2,700 domestic companies with market capitalizations under 200 million dollars, the following pages highlight selected top-ranking firms, in terms of share price performance for the 26-week period ending 9/30/04. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. While past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a micro-cap investor's close consideration.

Gain/Loss for the
26-Week Period
Ending 9/30/2004



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Key Manager Statement

"IDG's product and process expertise drives documented cost savings and efficiencies for our manufacturing customers. Demand from manufacturers has driven our FPS services to a 21% CAGR over the past three years and to 54% of IDG's total revenues. The higher profitability of our FPS services has led to double digit revenue growth, strong financial results, and increasing value for investors."

Andrew Shearer, President & CEO

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Key Manager Statement

"A heightened focus on healthcare has prompted government and industry leaders to look to information technology for quality and cost improvement. As a healthcare I.T. authority and industry leader, Superior is well-positioned to capitalize on this growing market."

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Key Manager Statement

"Gold has recently been a top performing asset class as it tends to move counter to the direction of equity markets and the US dollar and therefore provides a form of portfolio insurance."

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Key Manager Statement

"Since our launch 4 years ago, we have selectively acquired a number of outstanding companies and profitably grown to a projected 2004 run-rate of \$50 million. With worldwide IT business expected to exceed \$600 billion by 2006, 60% of which will be conducted by highly specialized companies such as ours, we are well-positioned to continue our double digit growth."

David M. McCarthy, CEO

THE EQUITY INVESTOR'S 26-WEEK MICRO-CAP REVIEW

Titan International Inc. • TWI • Manufacturing

Quincy, IL • IR Contact: Lisa Ross • 217-221-4489
www.titan-intl.com



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Key Manager Statement

"Titan's 1,800 employees are the primary reason for the company's success. Together we have built Titan to focus on the unique wheel and tire needs of farmers and construction contractors. Current factors such as the farm bill and increased crop output for ethanol production will translate into growth in equipment needs and Titan is ready to respond. Visit Titan to see how an American manufacturer works."

Morry Taylor, President & CEO

Analysts International • ANLY • IT Services

Minneapolis, MN • IR Contact: Bill Bartkowski • 612-344-1012
www.analysts.com



Analysts International is a \$332 million diversified IT services company. As of October 2, 2004, the company has recorded four consecutive quarters of improving revenue and profitability. Clients include the Fortune 500, small and midsize businesses and a variety of government entities. Current lines of business are: full service staffing, providing resources for supporting IT staffing needs; business solutions services, providing business solutions and infrastructure services; and outsourcing services, providing onshore and offshore strategic solutions. The world's best-in-class technology organizations are among Analysts International's business partners.



technology organizations are among Analysts International's business partners.

Key Manager Statement

"Coming off our most profitable quarter since mid-2000, we are a lean, competitive organization with a strong balance sheet, strong customer relationships, great talent and a recovering marketplace. We are committed to increasing shareholder value by meeting and exceeding customer needs and demands both today and well into the future."

Jeff Baker, President

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Brooke Corporation has over 300 franchise locations and was recently rated by industry publications as the #1 franchisor in its industry category, 66th fastest growing US franchise, and 47th largest US insurance broker. Brooke believes that the opportunity for business ownership provided through its franchise program is the ultimate tool for rewarding sales performance and motivating insurance professionals. Therefore, Brooke's primary mission is to enable insurance professionals to purchase businesses through acquisition financing and help insure business success through a proven business model, expert advice and administrative assistance.

Key Manager Statement

"Our franchise program 'levels the playing field' for local business owners and has gained increasing popularity with insurance professionals as demonstrated by the 63% increase in 2003 revenues from the previous year."

Robert Orr, Chairman & CEO

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Key Manager Statement

"Nobility continues to out-perform the industry and management is optimistic for fiscal 2005, convinced that its specific geographic market is one of the best long-term growth areas in the country and because of the strong operating leverage inherent in the company. Additionally, increased demand for Nobility's homes is expected as a result of the destruction caused by recent hurricanes in Florida."

Terry Trexler, President

Isonics Corporation • ISON • Homeland Security & Isotopes

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www.isonics.com • www.trilogy-capital.com/tcp/html/isonics.htm



Isonics corporation

Isonics has three business divisions. It is a world leader in the production of isotopically pure silicon-28 semiconductor wafers that possess thermal conductivity properties superior to ordinary silicon, enabling higher performance. The company provides medical isotopes for treatment of cancer and other health-care applications. Its Homeland Security and Defense division develops technology to combat international terrorism. The company is presently developing a family of neutron-based devices that scan for concealed explosives, drugs, or chemical and biological agents. The first neutron-based product, NeuroTest™, will be a handheld device for scanning small packages and other suspicious articles.

Key Manager Statement

"Our three businesses each address important and large markets with advanced technology solutions. We've recently concentrated additional company resources in our Homeland Security division to accelerate delivery of our neutron-based detection products to the market, where they can aid law enforcement in their efforts to protect the public."

James E. Alexander, Chairman & CEO

Innodata Isogen • INOD • Content Supply Chains

Hackensack, NJ • IR Contact: Al Girardi • 201-488-1200
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Innodata Isogen has solution centers and certified production facilities in North America, Europe and Asia, employing 7,000-plus content specialists worldwide. Clients include leading publishers, Global 2000 enterprises, government agencies, and major archives, libraries and museums.

Key Manager Statement

"Innodata Isogen is thriving at the intersection of three major trends: the expansion of a knowledge-based economy; the continued growth of digital technologies; and the seismic shift to business process outsourcing by major corporations worldwide. The extraordinary value we create for clients is driving our success."

Jack Abuhoff, Chairman & CEO

Their Losses, Your Gains

Funds hit hard by the tech bust are back—with tax holidays for investors

INVESTORS IN THE \$9 BILLION Janus Twenty Fund may well have their cake and eat it, too. Not only is it this year's top-performing large-cap growth fund, up more than 17%, but what's even sweeter is that Uncle Sam won't get his mitts on those gains for some time. Janus Twenty, like many funds nursing a nasty hangover from the tech bust, has accumulated billions of dollars in losses that it can use to offset future capital gains. The result: tax-free returns, at least for now. "The good news today for many fund investors, even for those just buying into a fund, is that they're getting a free ride on taxes for a few years," says Russel Kinnel, director of fund research for Chicago fund tracker Morningstar Inc.

Chalk it up to the vagaries of the U.S. tax code. As with stocks, mutual-fund investors trigger a capital-gains tax charge if they sell at a profit. Funds, however, come with an added twist that can wreak havoc on a taxable portfolio. They must pay out 98% of any capital gains they earn when selling stocks in their portfolios. Investors then must pay taxes on those gains the same year—even if they continue to hold the fund.

But many fund investors are now getting a tax holiday. Two years after the stock market pulled out of its dive, the

average domestic equity fund still has capital losses—both on stocks it has sold and those it still owns—equal to more than 15% of its assets, according to Morningstar. That's not just because of the market's earlier sharp drop. A huge number of investors also fled poor performers, forcing the funds to sell stocks at rock-bottom prices and take big losses.

Such losses on the books are giving mutual-fund investors a rare chance to

enjoy tax-deferred gains. For as long as the capital losses last, investors can buy a fund and avoid taxes on gains until they sell, just as they would with a stock. It gives investors another vehicle—at least temporarily—for building tax-deferred savings after they've maxed out their IRAs or 401(k)s. Taxable funds may not have the same perks, but neither do they carry such severe restrictions.

Of course, investors need to weigh other factors such as expenses, performance, and strategy in picking a fund, warns New York financial planner Gary Schatsky. Consider Fidelity Aggressive Growth Fund, which has a tax loss of \$13 billion—nearly three times as much as its assets. The fund toned down its aggressive, high-octane formula. Instead of focusing on about 100 stocks in a handful of indus-

Big Shields

Growth and technology funds have the largest losses that can offset future capital gains

TYPE OF FUND	POTENTIAL CAPITAL LOSSES*
Technology	-169%
Large-Cap Growth	-42
Mid-Cap Growth	-35
Small-Cap Growth	-19
Large-Cap Blend	-5

*As a percent of funds assets. Data: Morningstar



es, it now owns more than 350 stocks and largely avoids big bets on individual stocks. But the new manager is still unproven: The fund has risen 9.6% over the past 12 months, ranking it in the bottom half of similar funds. Says Schatsky: "Tax losses should be considered in the final analysis, not as the driving force."

Losses run deepest at large-cap growth and technology funds, which got hit the hardest when the technology bubble burst. The \$4.4 billion T. Rowe Price Science & Technology Fund shed 75% of its value between 2000 and 2002 and still has \$5.8 billion worth of losses. "The fund can more than double without [making] a distribution," says Sam Beardsley, head of tax for T. Rowe Price Group Inc. "It's the perfect efficiency."

Perfect, and enduring: Losses can be carried forward and applied to future gains for up to eight years. As a result, some investors may enjoy tax-free gains well into the next decade. A significant chunk of Fidelity Aggressive Growth's losses don't expire until 2011.

Not every fund is a tax-free zone, of course. Value funds, particularly those that invest in small companies, have performed well over the past five years, and many could make a distribution this year. Even so, their investors may not owe Uncle Sam very much. A study in April by fund research firm Lipper found that mutual-fund investors paid \$1 billion in taxes on gains last year, compared with \$15 billion in 2000, the most in at least a decade. "The distributions we've seen in the last three years are some of the lowest in a decade," says Tom Roseen, senior research analyst for Lipper. "I believe the distributions in 2004 will not be as low in recent years, but they will be very low."

Regardless of this year's payout, taxes may become less of an issue if Representative Paul Ryan (R-Wis.)

The Tech Bust's **Silver Lining**

Some funds have such large past losses that they won't have to pay out capital-gains distributions for years—in some cases, until 2012:

FUND	CAPITAL LOSSES * (BILLIONS)	% OF TOTAL ASSETS	YEAR-TO-DATE RETURN**	S&P STAR RATING
Fidelity Aggressive Growth	\$13.0	267%	7.6%	2
Janus	10.3	78	1.4	3
Vanguard U.S. Growth	7.2	119	3.3	1
Janus Mercury	7.0	156	5.5	3
T. Rowe Price Science & Technology	5.8	133	-1.0	3
MFS Massachusetts Investors Growth Stock	5.7	65	5.4	3
Janus Twenty	4.8	53	17.3	4
Putnam Voyager	4.7	35	2.0	2
Putnam Vista	4.3	152	14.0	3
Fidelity Select Technology	2.9	140	-2.2	3
White Oak Growth Stock	1.7	108	-6.2	2
Van Kampen Aggressive Growth	1.2	86	11.4	3
Vanguard Growth Equity	0.7	84	1.5	3
American Century Giftrust	0.6	69	3.1	2
FPA Paramount	0.2	75	13.2	4

*As of the most recent reports

**As of Nov. 29

Data: Morningstar, S&P the funds

gets his way. Last year he proposed legislation that would have kept mutual-fund investors from being taxed until they sold their fund shares—as with stocks—thus eliminating periodic capital-gains distributions. The bill, in part, got drowned out in the hullabaloo surrounding the mutual-fund scandals. But Ryan plans to submit the proposal again. "No other financial product has the same tax treatment," says Dan Crowley, head of government affairs for the Investment Company Institute, the mutual-fund industry's trade body. "We just want mutual funds to be treated like regular stocks."

A SAVVY CHOICE

TAX-CONSCIOUS investors have plenty of choices. Consider top-notch small-cap blend funds FPA Perennial Fund Inc. and FPA Paramount Fund Inc. They have identical managers and holdings and sport the same three-year annualized return of 14%. Yet Paramount probably won't pay a distribution until at least 2010, while Perennial paid out \$1.07 a share this year. How come? After managers Eric S. Ende and Steven R. Geist took the reins of Paramount in 2000, they sold all of its holdings and amassed some \$180 million worth of capital loss-

es while remaking the eclectic, concentrated portfolio into a diversified one like Perennial. Ende says they'll consider merging the two funds once Paramount's tax losses are used up or expire. But right now, Ende says, "the choice seems pretty straightforward" for tax-savvy investors.

The tax-free ride won't last forever. As the market has risen, mutual funds have been steadily chipping away at their mountain of losses. T. Rowe Price Science & Technology used \$470 million this year to offset gains in the fund, including a \$19 million profit it took on Cisco Systems. Some have used up nearly all their losses. After two years of sizzling performance, the \$550 million Brandywine Blue Fund has cut its reserve of tax losses by 70%. The fund estimates that it can now realize modest gains of just 95¢ a share before it will have to resume paying out capital-gains distributions.

Still, for many investors, there's a unique opportunity. The taxman cometh, but he taketh nothing away—just yet. ■

—By Adrienne Carter
in New York

BusinessWeek online For an extended list of mutual funds, please visit online at www.businessweek.com/magazine/extra.htm



Where's That Quarterly Report?

Companies, striving to clean up their books, are filing late—and seeing shares fall

IF MEDICINE SOMETIMES HAS TO taste bad to be good, then the bitter tonic companies are swallowing as they clean up their financial reporting ought to work wonders. Rigorous new examinations prescribed by the Sarbanes-Oxley Act are making it hard for executives to close their books and report their financial results to the Securities & Exchange Commission on time. In just one week in early November, 61 companies with a market cap of \$100 mil-

lion or more announced they would be late with their filings, including info-tech giant Electronic Data Systems, General Motors, and Suntrust Banks. That was up 25% from the same period a year ago, according to Glass, Lewis & Co., an independent researcher.

There has been no letup in the trend. Since then, mortgage giant Fannie Mae filed notice that it would be late as well. The problem isn't confined to big companies, either. Smaller outfits, such as

restaurant chain Benihana Inc., have found themselves in the same boat.

More problems are likely to surface the weeks leading up to Mar. 15. That's the first deadline for executives of large companies with calendar fiscal years to certify that they've checked and found their internal financial controls are working. Outside auditors also will have to issue their own certification. Before the next year is over, says Dennis M. Nally, chairman and senior partner of PricewaterhouseCoopers, 10% to 20% of all U.S. companies may uncover weaknesses in their controls. Some of them will have to delay their reports while they work out whether the weaknesses have created big errors in their numbers.

CRIMPED POSSIBILITIES

THAT'S BAD NEWS, because the effect of delayed filings can be devastating. Companies (and their investors) often find themselves in a state of limbo in which their financials become suspect, shares plummet, and they can become targets of aggressive value investors (page 128). Those listed on the NASDAQ even have a scarlet letter—an extra “E”—tacked on their stocks' tickers to show that their financial reports are incomplete. Twenty-five stocks, including Analogic Corp., carry this mark of shame.

Even worse consequences can arise. Filing late could trigger default clauses on bank loans—forcing companies to pay higher interest rates, put up more security, or repay early. The SEC also can bar late filers from issuing or trading certain types of securities, crimping their financing possibilities. In the worst case, companies could be pushed out of the stock market. Nortel Networks has said that technically it could be delisted from the New York Stock Exchange if it doesn't complete its 2003 annual report—now eight months overdue.

Why are so many businesses struggling? Apart from having to fix lax internal bookkeeping, they face stricter applications of accounting standards than before. Both result from laws Congress passed in 2002 after the Enron and WorldCom scandals. The new rules are forcing executives, directors, and auditors to turn over more rocks and root out bad accounting. “The incentive for all parties to get the right is much greater today than it was pre-Sarbanes-Oxley,” says Nally.

Accountants are under even greater pressure: Their audits are subject to potentially career-wrecking review by the new Public Company Accounting Oversight Board. But they're also feeling more powerful in their dealings with executive



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Running Behind

As auditors and regulators get tougher, companies increasingly are failing to get financial reports to the SEC on time. Some recent examples:

COMPANY / MARKET VALUE	PROBLEM	COMPANY COMMENT
ELECTRONIC DATA SYSTEMS 11.6 billion	Dispute with auditor over asset write-down; multiple lapses in internal financial controls	Resolved issues and filed report; CEO has said issues "not of any great significance"
FANNIE MAE 69.4 billion	Its regulator alleges improper accounting	Accounting follows generally accepted principles
FLOWERVE 1.4 billion	Errors found in internal accounting; two quarterlies overdue	Cooperating with an SEC investigation is slowing work
GENERAL MOTORS 21.9 billion	Applied stricter accounting and moved \$6.8 billion of liabilities and mortgage assets onto balance sheet	Filed one day late while seeking accounting interpretation from the SEC
INVESTORS FINANCIAL 2.9 billion	Errors in accounting for purchases of mortgage-backed securities	Fixed problems and filed reports
MOLEX 5.1 billion	Dispute with auditor over reporting of inventory accounting problem	Did not return calls
NORTEL 15.4 billion	Failure of internal controls; correcting previous reports	Company has 650 people working to complete reports
SUNTRUST 27.0 billion	Correcting earlier reports after finding weakness in internal controls	Let go three officers and finished reports

*As of 11/15/04

Data: Glass, Lewis; Bloomberg Financial Markets, 10-K Wizard Technology; BusinessWeek

because they're getting more attention from the audit committees of boards, especially as annual audits approach.

Auditors and companies are also reviewing—and sometimes changing—how they interpret and apply accounting principles. For example, a GM spokesman said the company was a day late filing its quarterly report on Nov. 10 because it wanted a current interpretation from the SEC of a rule on how to account for asset-backed securities. GM brought \$6.8 billion of assets and related liabilities onto its balance sheet. And after Fannie Mae was blasted by its primary regulator in September for its accounting for derivatives and the costs of acquiring mortgages, at least five companies said they would file late because they were reviewing similar issues. Fannie says its accounting is by the book.

A GREATER UNDERSTANDING

THE QUARTERLY REPORTS due by mid-November seem to have given executives fits enough. For example, as EDS approached its scheduled Oct. 26 third-quarter-results announcement, CEO Michael Jordan found himself arguing with KPMG auditors over whether EDS should take a charge for the cost of extra computer

equipment and software it acquired for a big Navy contract that was cut back. The dispute forced Jordan to postpone his announcement twice, reveal that KPMG was asserting the company had deficient internal controls, and miss EDS' deadline for filing its report. When EDS finally announced results nearly a week later, on Nov. 15, it took a \$375 million charge on the computers plus some small expenses on other items. "These did not turn out to be of any great significance," Jordan insisted in a conference call with investors the next day. "It doesn't matter, really."

The stock market seemed to agree: EDS shares rose 2.7% the next day. But the episode was more significant than one day's trading results. Investors now understand more about the risks EDS takes on big contracts and the accounting judgments it makes. "I've got to give the auditors kudos," says Lynn E. Turner, research director at Glass, Lewis, who often fought with big auditing firms when he was SEC chief accountant. "We are seeing more cases where they are willing to stick to their guns and, in this pro-

cess, get more information to investors."

Jordan's fight with KPMG was a mere tussle compared with the war between auditors from Deloitte & Touche and Molex, a Lisle (Ill.) manufacturer of electrical components with \$2.2 billion in sales. On Nov. 11 the company said it was late filing its quarterly report and had demoted its chief financial officer. Deloitte auditors had complained after discovering that executives had not told them about an earlier mistake in valuing inventory. Two days later, on a Saturday, Deloitte demanded that the CEO be replaced, too. The Molex board unanimously rejected the demand. On Nov. 15 Molex announced Deloitte had quit and it had filed with the SEC. "We strongly disagree with their approach," Molex co-Chairman Frederick A. Krehbiel said in a written statement at the time. The company did not return calls asking for comment. In a letter to the SEC, Deloitte stood by its actions.

FORMAL INVESTIGATION

SUCH PROBLEMS CAN SEND company shares on roller-coaster rides. On Oct. 21, Investors Financial Services Corp. decided to delay filing to correct the way it accounted for purchases of mortgage-backed securities. Its stock plunged 16%. Three weeks later, after IFS had amended three years of results, its stock had recovered. CFO John N. Spinney Jr. says the company found the problem during a review of internal controls.

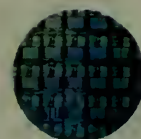
Likewise, shares of Flowserve Corp., a \$2.4 billion maker of oil and chemical pumps, plunged 11% on Oct. 27 after the company said it would be late with a report and had to correct previously announced earnings. Flowserve said it had discovered material weaknesses in its internal controls and that some expenses had not been recorded in the right periods. Earlier, similar problems had triggered a formal SEC investigation. Flowserve has replaced its CFO and pledged to spend \$15 million to fix its bookkeeping; its shares have recovered. A company spokesman says that cooperating with the SEC is slowing work on current reports.

Between wild stock swings and fights with auditors, the next several months will be all too memorable for investors and executives. But if the new scrutiny delivers more trustworthy numbers, the nasty medicine will have worked. ■

—By David Henry in New York, with Andrew Park

Accountants are subject to potentially career-wrecking reviews

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Where Others See Trouble...

Jeffrey Ubben is finding bargains in companies with accounting snafus

THE NEWS FROM MSC SOFTWARE Corp. turned from bad to worse. On Aug. 11, the Santa Ana (Calif.) company reported it was expanding a six-month-old internal audit at a foreign subsidiary. Because of the inquiry, MSC hadn't filed financial statements with the Securities & Exchange Commission for nine months. For many investors, the widened probe was the last straw—MSC's stock fell to a 52-week low of \$6.14. But for San Francisco hedge fund ValueAct Capital Partners, it was the beginning of what could be a beautiful friendship. The fund scooped up a million shares, which have since rebounded to as high as \$9.89.

To Jeffrey W. Ubben, the firm's managing director, companies such as MSC are newfound manna. Thanks to tougher accounting rules, some public companies are forced to launch lengthy audits and delay filing their financials when snafus arise. Though the problems often turn out to be minor, a company's stock usually plunges during the delay, creating a buying opportunity. Before, these were rare,

says Ubben, but they now make up a whole category of investments. His firm has invested a fifth of its \$1.5 billion fund in such tardy filers. So far, it appears to be alone in dipping into such a treasure trove of undervalued gems. Ubben won't reveal the fund's returns, saying only that they've averaged in the double digits since its launch in 2000.

Ubben, 43, is best known for chairing Martha Stewart Living Omnimedia Inc. for 13 months, until last July, while the company's founder was fighting her legal battles. ValueAct owns 21% of Omnimedia, and Ubben has been a director since 2002. Before co-founding ValueAct, he was a managing partner at San Francisco private equity firm Blum Capital Partners. Ubben got his start at Boston's Fidelity Investments, where he managed the

SIMPLE MATH
"The cash flow doesn't lie," says Ubben

Fidelity Value Fund
He contends that weeding out the real deadbeats from the late filers is simple

"The cash flow doesn't lie," he says. ValueAct hunts for undervalued companies that are about 20 years old, have done a few acquisitions, and generate roughly \$300 million to \$1 billion in annual sales from a core business. Their cash flow should appear highly consistent, making it easy to spot accounting trickery. When the fund finds a promising target, it begins buying stock, often seeking to become the largest outside shareholder. It then uses its influence to boost the company's performance over several years.

NEW STRATEGEM

THE SNAGS THAT hold up filings often start small. One company, Catalina Marketing Corp., delayed its annual report in June, 2003, after the auditors questioned whether revenue in a division was added to the books at the right time. While an audit dragged on for almost a year, Catalina filed no financials, its stock dropped 33%, to \$12, and ValueAct bought 12% of its outstanding shares. In the end, the company had to reassign revenue to different fiscal years, but total sales didn't change. The stock has since risen to \$28.

Now ValueAct is adopting a new tactic: attempting to take late filers private. In September, tired of the continuing audit at MSC, it offered to buy the 91% of the company it didn't own in a deal that valued MSC at \$274 million. Going private, ValueAct argued, would free MSC from filing public reports and reward long-suffering shareholders. MSC's board rejected the offer, saying the audit

made it impossible to value the company.

But matters may not end there. "An offer to go private opens up a lot of eyes and ears," says Justin Cable, an analyst at B. Riley & Co. B. Riley is making a bid, Ubben may have put MSC in play. If the company accepts a better offer, ValueAct won't gain ownership, but it will get a handsome return on its shares—and more money to plow into another delinquent filer.

—By Justin Hibbard in San Mateo, Calif.

Delinquency Pays

ValueAct Capital has invested a fifth of its \$1.5 billion hedge fund in companies that have missed SEC filing deadlines

COMPANY	PERCENTAGE OF FUND*
Catalina Marketing	11.4%
Per-Se Technologies	5.7
MSC Software	1.2
Seitel	1.1

*As of Sept. 30

Data: ValueAct Capital

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TEMPUS VITAE

A man wearing a red hard hat, a light blue dress shirt, and a dark tie is being hoisted into the air by a group of diverse construction workers. The workers are cheering and have their arms raised. The background shows a construction site with a corrugated metal roof.

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SPECIAL REPORT



» HEAR-SIGHTED

Oakley Thump sunglasses

Oakley brings a new dimension to high-performance eyewear: sunglasses with a digital audio player built in. The 256-megabyte version (\$495) holds 120 tunes and the battery plays for six hours between charges. Earpieces—and lenses—pivot out of the way when you don't need them (800 969-2895, oakley.com).

THE BEST PRODUCTS OF 2004

Some of these gadgets help save time. Others conserve energy. But nearly all are guaranteed to produce fun, which we can all use more of

EDITED BY LARRY ARMSTRONG

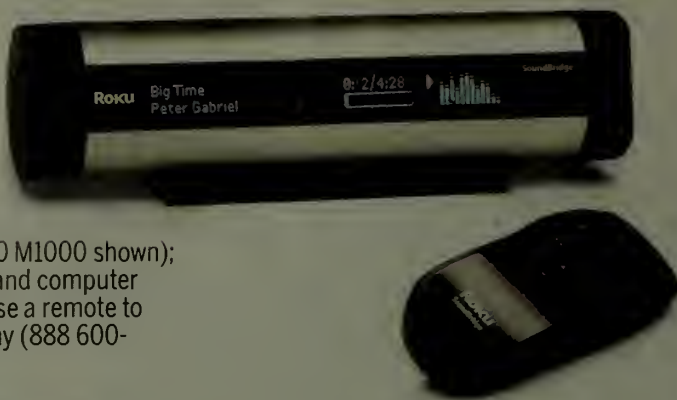


BEST PRODUCTS OF 2004

» MOVING MUSIC

Roku SoundBridge

SoundBridge is an elegant way to get digital music stored on a PC or Mac to play on your stereo. There are two models that differ only in display size (\$250 M1000 shown); both hook up easily to your stereo and computer over a wired or wireless network. Use a remote to pick music off the bright LED display (888 600-7658, rokulabs.com).



« CELL SENSATION

Aliph Jawbone headset

It's hard to use a cell phone in the noisiest places—moving cars, airports, and shopping malls—because the background noise often drowns out your conversation. The Aliph Jawbone headset (\$150) uses two microphones: One picks up the sound, including your voice, the conventional way. The second rests on your jaw to sense vibrations, so it knows what part of the sound is talk. Signal processing technology then subtracts out virtually all of the noise (866 529-2663, jawbone.com).



▲ A STEADY BEAM

Ryobi AIRgrip laser level

This level uses a tiny vacuum stick to painted, papered, and paneled walls. The laser is visible for 30 feet and turns 90 degrees both horizontal and vertical. It's \$40, only at Home Depot (800 525-2579, www.ryobitools.com).



▼ BIG RED GOES GREEN

2004 Honda CRF250X motorcycle

Honda built a race-ready off-road bike (\$5,999) that's clean enough to meet emissions rules in 50 states: You can ride it year-round. The fun begins with the starter button, or just kick it the old-fashioned way (866 784-1870, powersports.honda.com).





PRETTY PICTURE PERFECT

Hewlett-Packard Photosmart R707 digital camera

Good-bye to bad snapshots with this 5.1 megapixel, pocket-size shooter (\$300). It fine-tunes high-contrast photos to bring colors out of shadows. Take up to five shots and see the resulting panorama on the camera's 1.5-inch screen. Red eye? For the first time you can fix it in the camera instead of editing it out on a computer. The dock is \$70 extra (800 752-0900, hp.com).

CLOSET CASE

Maytag Neptune Drying Center

Speed-dry sneakers and sweaters in Maytag's Neptune Drying Center (\$1,200), a unique drying cabinet built on top of a traditional tumble dryer. The clothes rod at the top swings in the heated air to remove wrinkles, or use it to freshen up clothes that you'd normally dry clean (800 688-9900, maytag.com).



▲ ONE SMART PHONE

Motorola Razr V3

With all the goodies stuffed into cell phones—from cameras to MP3 players—they've been fattening up. That is, until the Razr rang in. A half-inch thick, it makes Motorola the new king of thin. But this \$500 pocket-pleaser doesn't miss a beat. Designers hid a camera in the hinge, buried a 3D graphics engine beneath the keypad, and jazzed up the speakers. The result? Great acoustics and images from a sharp-looking phone (866 246-4852, cingular.com).

BEST PRODUCTS OF 2004

OPEN-AND-SHUT

MINI Cooper S convertible

No weekend runabout was as fun as the MINI Cooper S—until the ragtop (\$24,950) came along. Press once, here comes the sunroof. Press again, the top retracts completely (866 275-6464, mini.com).



BRUSH AND RUN

Oral-B Brush-Ups finger toothbrush

Not to offend, but maybe garlic chicken for lunch wasn't such a good idea. Wipe it away with Oral-B Brush-Ups, a disposable fingertip toothbrush that freshens your breath and gives you that just-brushed feeling (\$2.49 for a package of 12). The toothpaste is built in, and no rinsing is necessary (800 566-7252, oral-b.com).

GOING MOBILE

Delphi MyFi portable satellite radio

Finally, a battery-powered satellite radio you can take with you (\$350; \$10/mo. for XM radio service). Clip it to your belt hook it up to your stereo, or use it in your car. And you can record five hours of favorites for subways and airplanes where you can't get a signal (877 463-3574, delphi.com).



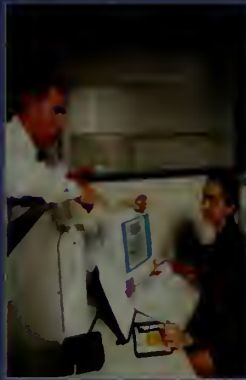
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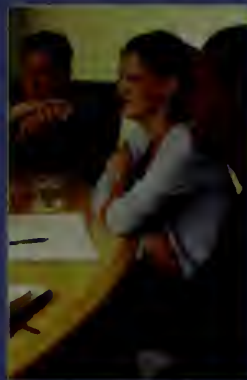
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BEST PRODUCTS OF 2004

HOPPING GLAD

Flybar 1200

The original pogo, from SBI Enterprises in 1918, can't shake a stick at the company's newest model. Flybar 1200 (\$300) has a dozen adjustable rubber thrusters that can get experienced riders up to eight feet off the ground. And unlike spring-driven pogos, you won't bottom out (800 764-6784, flybar.com).



BERRY GOOD

RIM BlackBerry 7100

BlackBerrys have been great e-mail but awkward as phone. Research in Motion solved the problem on its 7100 (\$200 off rebate from T-Mobile) by slimming down the body. The keyboard has two letters on many keys and uses software that guesses what you're typing (866-2453, t-mobile.com).

PHAT WHEELS

Chrysler 300C sedan

What does it take to get hip-hoppers to ditch their SUVs? The Chrysler 300C (\$32,870) has replaced the Hummer and 'Slade as the phattest ride. Its 340-horsepower Hemi V-8 can smoke just about any other car on the road and still get a respectable 25 mpg (800 247-9753, chrysler.com).



A FASHION TOUR DE FORCE

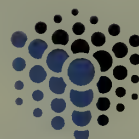
Lance Armstrong Foundation bracelet

It started as a way to mark cyclist Lance Armstrong's quest for a historic sixth Tour de France win, and to raise \$6 million for his cancer charity. But the \$1 yellow rubber wristband quickly became a fashion must-have. It has sold more than 20 million so far (877 932-7935, laf.org).

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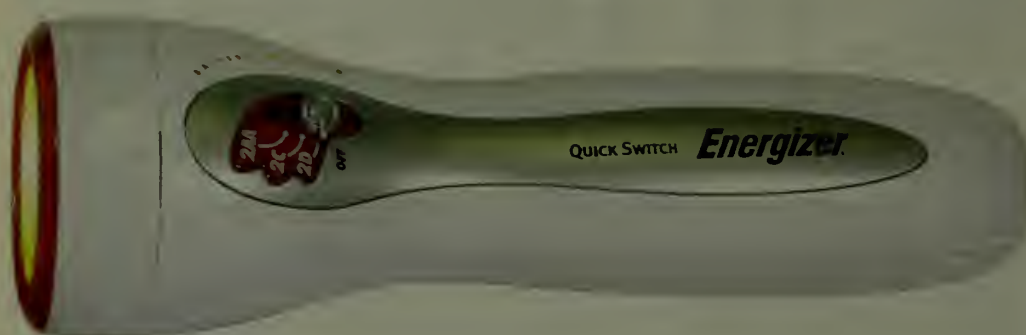
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BEST PRODUCTS OF 2004

» ENVIRO MACHINE

Ford Escape Hybrid SUV

Finally, an SUV for the greener-than-thou crowd. Detroit's first gas-electric combo is a compact SUV (\$26,970) that nature lovers can drive to the backwoods without guilt. The four-cylinder hybrid gets 33 mpg—50% better than the conventional Escape—and cranks out nearly as much horsepower as a V-6. Under 25 mph, this cute-ute scoots about town in its silent, all-electric mode. The batteries recharge when you're driving, so you never have to plug it in (800 392-3673, fordvehicles.com).



« SWITCHING CELLS

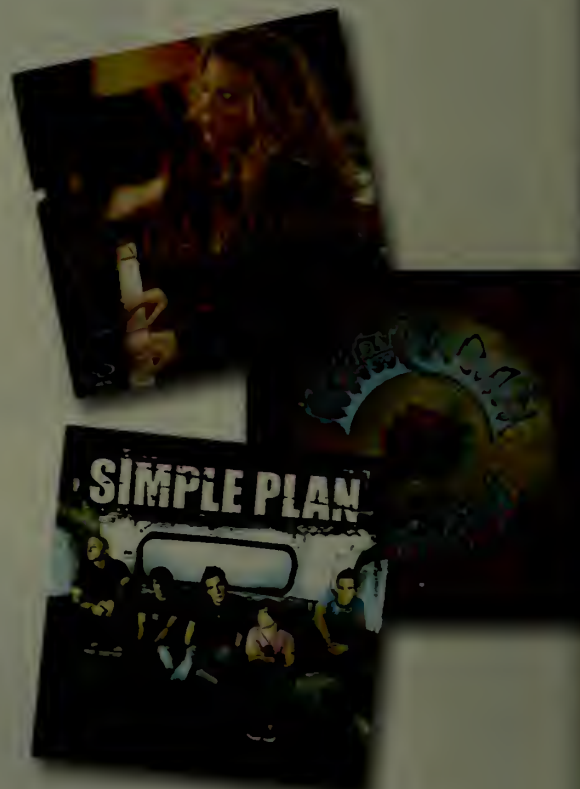
Energizer Quick Switch flashlight

You won't be caught in the dark when your flashlight goes dead and you can't find batteries that fit. With Quick Switch (\$12), you can use pretty much whatever size you have around. Just pilfer a couple of D cells, C cells, or even those little AAs from a remote control or your kids' toys (800 383-7323, energizer.com).

» ALL TEED UP—AND HOOKED IN

TaylorMade r7 quad driver

The r7 quad (\$499) comes with four metal plugs that golfers can install to alter the center of gravity of the club's head. Players with a penchant for hitting slices, say, could reposition the screws to the back left—creating counterbalance to keep their tee shots in play (800 888-2582, taylormadegolf.com).



» TWO FOR THE MONEY

DualDisc music CDs

There's no question that the extras have turned movie DVDs into best sellers. The music industry is listening up with a new CD format: DualDisc (\$12-\$18) is a disk with a CD album on one side and a DVD on the other for such extras as music videos, interviews, and concert footage. The flip side also repeats the entire album in DVD-Audio or surround sound (dualdisc.com).

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BEST PRODUCTS OF 2004



▲ FLAT STUFF

Apple iMac G5 computer

Apple Computer's streak of design hits continues with the newest iMac, an all-in-one desktop built around a 17-in. (from \$1,299) or 20-in. (from \$1,899) flat-panel display. All the electronics, including the superfast IBM G5 processor, an 80 gigabyte or bigger hard drive, and a CD or DVD burner, are hidden behind the screen, which seems almost to float above your desk on its brushed aluminum foot (800 692-7753, apple.com/store).

◀ OUT, DARNED SPOT

Mr. Clean AutoDry car-wash system

Drying your car by hand with towels can leave scratches and swirl marks, but if you don't wipe it down you'll end up with a car covered with white spots from the minerals in the water. Mr. Clean AutoDry, a \$20 soap-and-rinse dispenser that hooks up to a garden hose, uses a replaceable cartridge similar to the filters for faucets and pitchers to give your car a final rinse with de-ionized water. The water sheets off, and the car air dries with no white residue (800 208-0172, mrcleanautodry.com).



▲ DYNAMIC DUO

Sony Ericsson S710a mobile phone

Closed, it works like a digital camera with a 2.3-in., scratch-resistant screen and a shutter button on top for taking high-quality 1.3 megapixel snapshots. Swivel it open, and it's a full-featured cell phone (\$500) for talking, e-mailing, or browsing the Web. Extras include Bluetooth, an infrared port, and a slot for a memory card (866 766-9374, sonyericsson.com).

◀ LIGHTEN YOUR LOAD

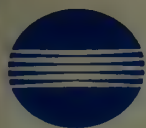
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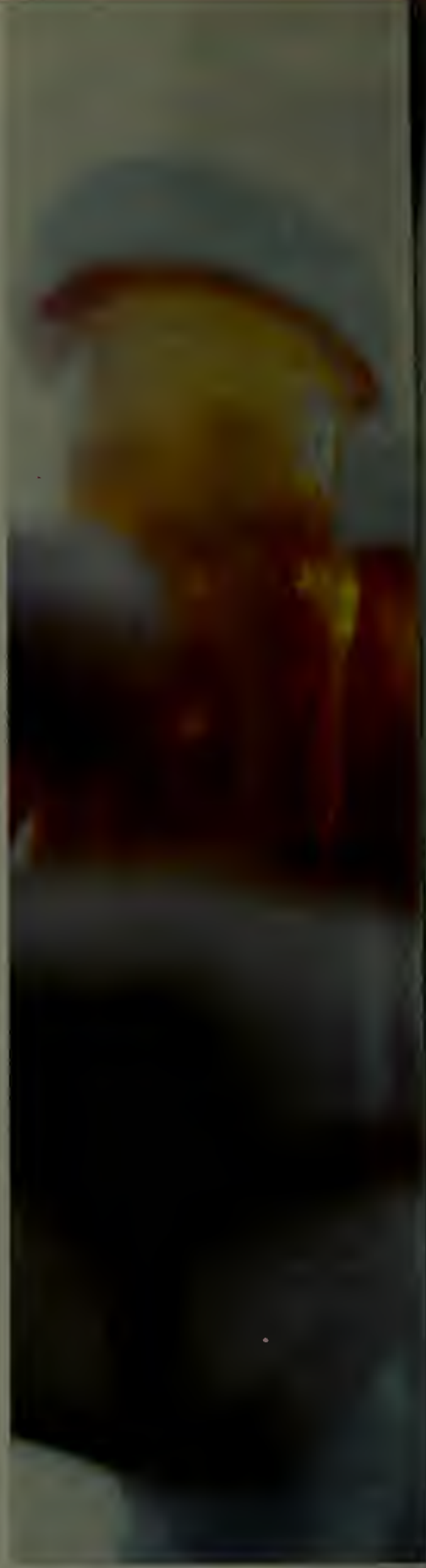
The Inside Dope on Drugs

Watchdog Web sites can tip you off to concerns that may not be on the label. **BY CAROL MARIE CROPPER**

FIRST IT WAS ANTIDEPRESSANTS. Then Vioxx. Now questions have been raised about the safety of yet another drug, the painkiller Bextra, made by Pfizer. Is there anything you can do to prevent the unnerving situation of finding out from news reports that a drug you've taken for months or years has been flagged for safety or even been withdrawn from the market? Yes there is. Asking doctors and pharmacists the right questions and tapping into the vast medical resources on the Web can help you avoid nasty surprises. In the cases above, information was available years before the recent news splashes that would have at least thrown up caution signs. Consider Vioxx. Drugmaker Merck withdrew the COX-2 inhibitor-type painkiller in September in the face of mounting evidence that the drug increases the risk of heart attack and stroke. But even a cursory Internet search two years ago would have alerted you to potential cardiovascular risks associated with the drug. You would have also learned that the

likelihood of the gastrointestinal side effects Vioxx was said to prevent were low for most patients. There was evidence, too, that as a painkiller, Vioxx was more effective than over-the-counter drugs available for a third of the cost.

Still, before you hit the Net, start with your doctor. Ask how long the drug has





other choices or the patient is allergic to the alternatives. Others are even more conservative. Dr. Sidney Wolfe, a physician and co-founder of advocacy group Public Citizen, believes patients shouldn't use a new drug until seven years after its introduction unless it is clearly a "breakthrough"—meaning it is the first to treat an ailment or represents a new and clearly more effective approach.

ONLINE WITH THE FDA

FOLLOWING WOLFE'S advice would have kept you out of Vioxx' way. Even Lau's counsel might have protected you, since by 2000 a Merck-sponsored study had uncovered the link between Vioxx and heart problems, though it did not explain the connection. By early 2001, the Food & Drug Administration was discussing and writing about those findings, with letters and memorandums posted on its Web site, www.fda.gov. One way to look for such information is by going to the FDA's home page, clicking on the "advisory committees" link, then going to "drugs." This can turn up issues raised in advisory committee hearings, especially those held around the time of a drug's approval. You can also click the "drug information" tab, then go to the "drug safety

Some doctors advise against using any new drug until it has been out for several years to allow more data to emerge

and side effects" section to uncover other material—in this case a warning letter from the FDA to Merck that discusses the cardiovascular findings.

One of the best ways to vet a drug is to obtain the drug's label (or *Physicians' Desk Reference* entry), available either from your doctor or the FDA site. Since April, 2002, Vioxx' label has referred to studies showing increased risk of heart attack and other cardiovascular problems. The label also showed that Vioxx was less likely to cause gastrointestinal problems than over-the-counter medicines. But the label adds that such problems affect only 1% of patients treated for three months to

six months, or 2% to 4% of patients treated for a year. You might have concluded that the risk Vioxx was designed to prevent wasn't worth the heart attack danger.

The FDA site isn't the only place where you could have seen concerns about the drug. Wolfe's organization has a Web site, worstpills.org, which charges for some content, and a subscription newsletter, *Worst Pills, Best Pills News*, that warns about drugs the group considers risky. The newsletter listed Vioxx on its "Do Not Use" list in April, 2001.

Or you could have gone to a site run by the Office for Oregon Health Policy & Research that compares the safety and effectiveness of various drugs by reviewing drug research. In 2002 that site, oregonrx.org, questioned whether COX-2 inhibitors provided a significant gastrointestinal advantage. Meanwhile, heart problems were a concern. Plus, the site reported there was no evidence that the COX-2s were more effective for treating pain than over-the-counter alternatives.

WHAT ELSE ARE YOU TAKING?

IN RESEARCHING drugs, you should also check with your pharmacist, who might know about side effects reported in the professional literature, says Michael Maddux, executive director of the American College of Clinical Pharmacy. While this wasn't the problem that took Vioxx off the market, several drugs have gotten into trouble because of interactions with other medications. To guard against that, let your pharmacist know about all the drugs you use, including those you buy elsewhere. Be especially careful to ask about interactions when accepting samples. You can also check for interactions at www.drugdigest.org, a free site produced by Express Scripts, a company that manages pharmacy benefit programs.

Keep an eye on medical news sites. Articles linking Vioxx to heart failure in elderly patients appeared last spring on webmd.com. The National Library of Medicine site, pubmed.gov, offers abstracts and citations from professional articles. Type the drug you're taking into the site's search engine and see what comes up. Keep in mind, though, that some studies showing negative results may not be published.

In the end, you might have chosen to take Vioxx, despite the risk, to avoid stomach bleeding. But at least you would have made an informed decision. ■

Cholesterol: The Bigger the Better

Patients with small "bad" particles are at greater risk of heart disease. **BY KATE MURPHY**

ALMOST EVERYONE knows that having too much "bad" cholesterol in your blood puts you at risk for heart disease. But not everyone with a high level of such low-density lipoprotein (LDL) suffers a heart attack or a stroke, and many people with normal LDL do. Indeed, only 50% of people with coronary artery disease have high levels of LDL or any other risk factor.

Research suggests this might be because the standard cholesterol screening tests measure only the percentage of LDL in your bloodstream—when it's the size and number of LDL particles that are important. Although further study is required to decide for sure, many doctors are convinced that getting a more thorough cholesterol test, one that identifies the types of particles, can improve treatment and save lives.

BAD VS. GOOD

LDL is a molecule that transports the "bad" cholesterol. It's bad because it tends to get stuck in arteries and cause blockages. High-density lipoprotein (HDL) carries the "good" cholesterol, which mops up bad cholesterol and takes it to the liver for disposal. LDL and HDL particles come in various sizes. The bigger the better. Studies indicate that small-particle LDL raises a person's risk of having a heart attack by a factor of three, possibly because the diminutive particles are much more likely to work their way into the arterial wall. They are also thought to oxidize more readily than larger LDL particles. This tendency magnifies their plaque-forming potential. Small HDL particles are much less effective at soaking up their bad brethren. But having



ARTERY WALLS Large particles of LDL (above) are less apt than small ones (below) to stick and cause blockage

small LDL (so-called pattern B) is by far the worse condition.

"Everybody agrees that patients with a preponderance of small LDL particles are at significantly greater risk for heart disease," says Dr. K. Lance Gould, a cardiologist at the University of Texas Medical School in Houston. "The difference of opinion is how aggressive we should be in testing for it and treating it." Gould advocates testing everyone who has at least one cardiac risk factor (for risk factors, go to www.americanheart.org/presenter.jhtml?

identifier=4726). The test, called subfraction analysis, costs around \$100 and is usually not covered by insurance unless the person already has heart disease.

TESTING, TESTING

THE AMERICAN HEART ASSN. (AHA) has no official guidelines for testing cholesterol particle size. "There isn't sufficient evidence yet to prove it's a better predictor" of cardiac risk than current measures, says Dr. Nieca Goldberg, AHA spokesperson. In treating her patients at Lenox Hill Hospital in New York, however, Goldberg says she tests for particle size in patients who already have heart disease but have a normal cholesterol profile or those who are

high risk for heart disease but have borderline LDL. Many doctors don't use the test, either because they don't know about it or because they prefer to make an inference from triglyceride levels. Some studies indicate that high triglycerides might be an indicator of small LDLs.

The size of your LDL particles can determine how you're treated. If you have pattern B particles, you'll want to lower your percentage of LDL down to around 70 milligrams per deciliter, which is substantially lower than the optimal 100 mg/dL that the AHA advises. While statin drugs such as Lipitor can reduce the amount of LDL in your blood, they have little or no impact on the size of the molecules. Therefore, doctors also advise taking hefty doses of vitamin

B3, or niacin, or drugs known as fibrates to increase both LDL and HDL particle size.

While reducing the amount of fat in your diet is important, people with small-particle LDL shouldn't go too low. Studies indicate your condition is likely to worsen if you get less than 25% of your calories from fat. Exercise, on the other hand, will help, with the greatest gains coming in proportion to the amount rather than the intensity of activity you do. When it comes to cholesterol, a long walk beats

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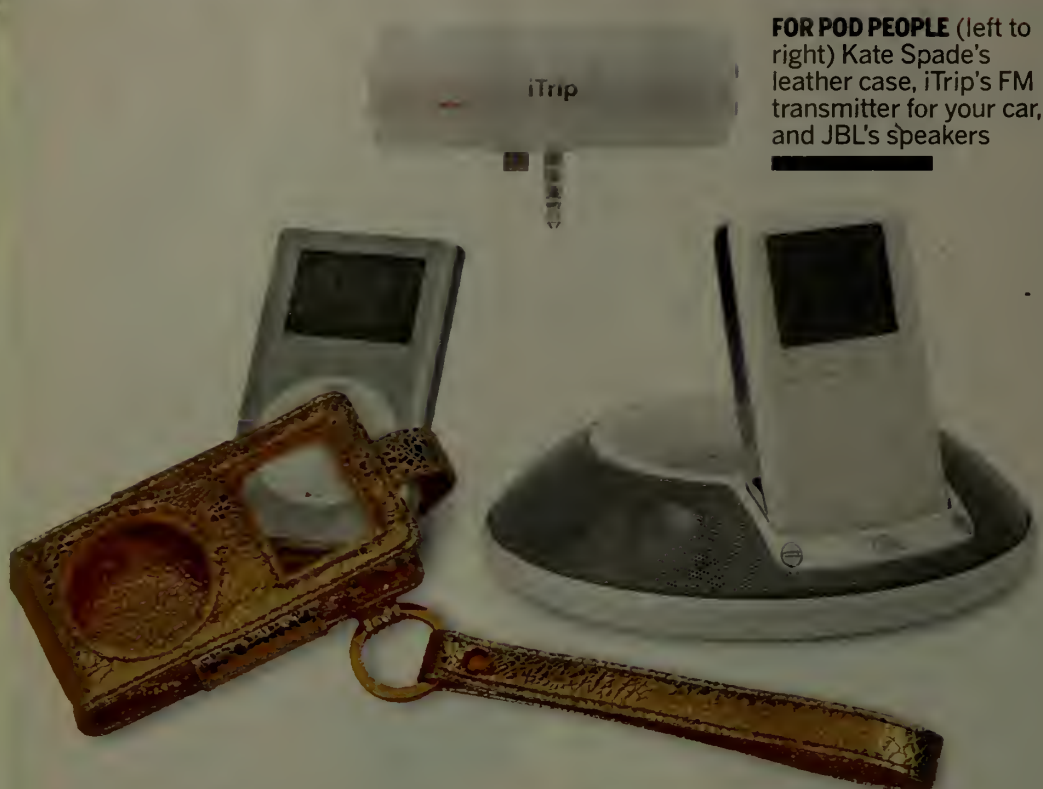


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FOR POD PEOPLE (left to right) Kate Spade's leather case, iTrip's FM transmitter for your car, and JBL's speakers

match the iPod's sleek look, starting with Bose's \$300 SoundDock (bose.com). Pop the iPod into its nest in front of the speaker and listen to the clear, rich sounds for which Bose is known. JBL's OnStage is a doughnut-shaped speaker system that nearly matches the Bose sound quality but costs \$100 less (jbl.com). Altec Lansing's \$180 inMotion iM3 speakers don't offer the same quality (alteclansing.com). But unlike the others, they fold up and come with a carrying case. All of the speakers recharge the iPod while it's docked.

As much as iPod owners love the device, they grumble a bit, too. The biggest complaint: ill-fitting earphones. Any replacement headphone will do because the iPod uses a standard jack. But there's something about that telltale white cord that lets others know an iPod is on the other end of the line. So Etymotic Research came out with its \$115 white ER-6i earphones that slip inside the ear canal and pump out superior sound (etymotic.com). They even come with two different sets of eartips so users can get a better fit.

ON THE ROAD

ROCKING OUT WITH headphones while you're driving is dangerous, so a handful of companies have come up with ways to play music from the iPod through a car stereo. Griffin's \$35 iTrip fits right on top of the player and sends out music over a free FM radio frequency that you select (griffintechnology.com).

The problem with an FM transmitter, though, is that it's prone to interference when you're driving in cities. One solution: Alpine Electronics' KCA-420i, a \$100 adapter that plugs iPods directly into Alpine's car stereo units (alpineusa.com). Drivers then navigate the iPod tunes using the stereo's controls.

HOT SUIT One of Incase's whimsical sleeves for the mini



What Are You Getting Your iPod?

With 5.7 million of them out there, makers of add-ons are vying to get in on the action. **BY JAY GREENE**

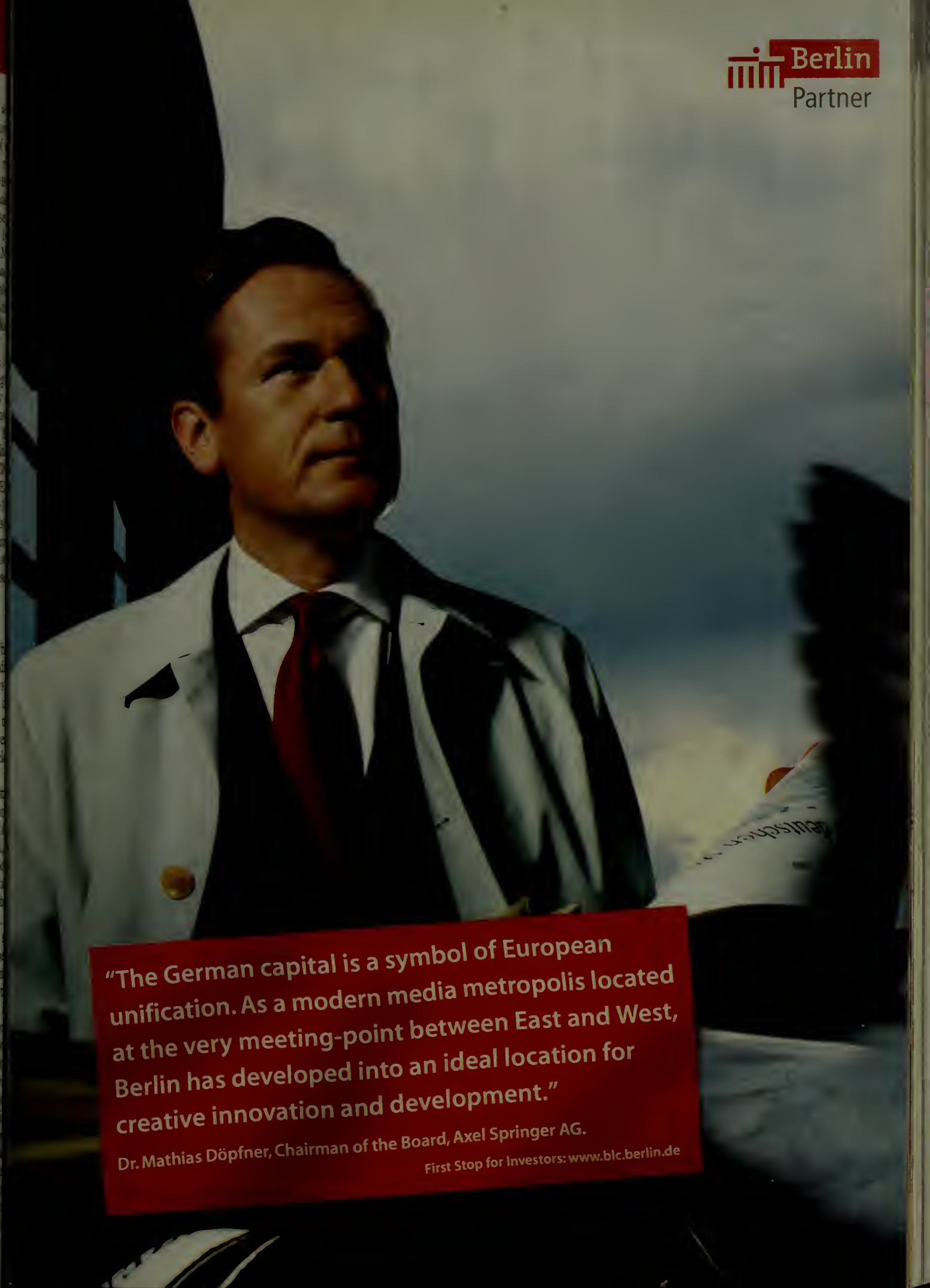
YOUR IPOD IS MORE than just a portable music player. It's an extension of you, full of your favorite tunes. It's almost like a fine suit or a designer watch—a status symbol that makes you feel better as soon as you slip the white earphones in. Your iPod does so much for you; shouldn't you do something for it?

Perhaps it's time to accessorize. With 5.7 million of the players out there, a cottage industry has emerged to sell iPod add-ons. Apple Computer offers them, too, but frankly, the goods from many other makers are better.

Let's start with a carrying case. WaterField Designs' iPod Case is a \$40 ballistic nylon home with a subtle color weave on the side and a flap that covers the device's face (sfbags.com). Most important, the

inside of the flap includes a little pocket for the earphones. Incase makes a handful of whimsical music-player holders, particularly for the iPod mini, including snazzy \$30 iPod mini sleeves featuring a "flame" design (goincase.com). The only drawback is that you have to slide the device in and out to get at the controls. The iPod has a haute couture wardrobe, too, including Kate Spade's shimmering gold crinkle leather case for the mini, complete with matching carry strap, for \$75 (katespade.com).

Sometimes you want to share your iPod's repertoire with friends. To do that you need speakers. A handful of high-end speaker makers have designed ones that



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EDITED BY DODDI GUTNER

WINE

A TOAST TO BRITISH BUBBLY

FRANCE'S CHAMPAGNE makers are facing a serious challenge from a most unlikely rival: the beer-loving British. In a recent blind taste test by *Which?* magazine, Britain's answer to *Consumer Reports*, seven English bubblys scored equal or higher to supermarket Tesco's premier cru French champagne.

International wine organizations—and even the French—are toasting England's efforts. In March, **RidgeView Estate** in Sussex, owned by former tech exec Michael Roberts and his wife,

Christine, won a silver medal at the august Paris Vinalies Internationales for its Knightsbridge 1999 vintage. In 2003, neighboring **Nyetimber Vineyard**, owned by Céline Dion songwriter Andy Hill, won a Vinalies gold medal for its 1995 Première Cuvée Blanc de Blancs.

Just as New Zealand vintners discovered their soil's affinity for sauvignon blanc, the Brits have found they have a flair for sparkling wine. The reason: The climate and soil of England's Southeast are nearly identical to those of

the Champagne region, 90 miles away.

While Britain's standards are high, production remains low. **Nyetimber** and **RidgeView** produce just 30,000 bottles each a year. Still, **Nyetimber** is now on sale in the U.S. from **Neiman Marcus** stores in Dallas and a handful of Dallas high-end restaurants. The award-winning 1995 **Nyetimber** sells for \$440 a case, compared with \$1,541 for 1995 **Dom Perignon**. That's a good reason to break out a bottle of British bubbly to celebrate the New Year. —Jane Black



INSURANCE

Paying a Premium

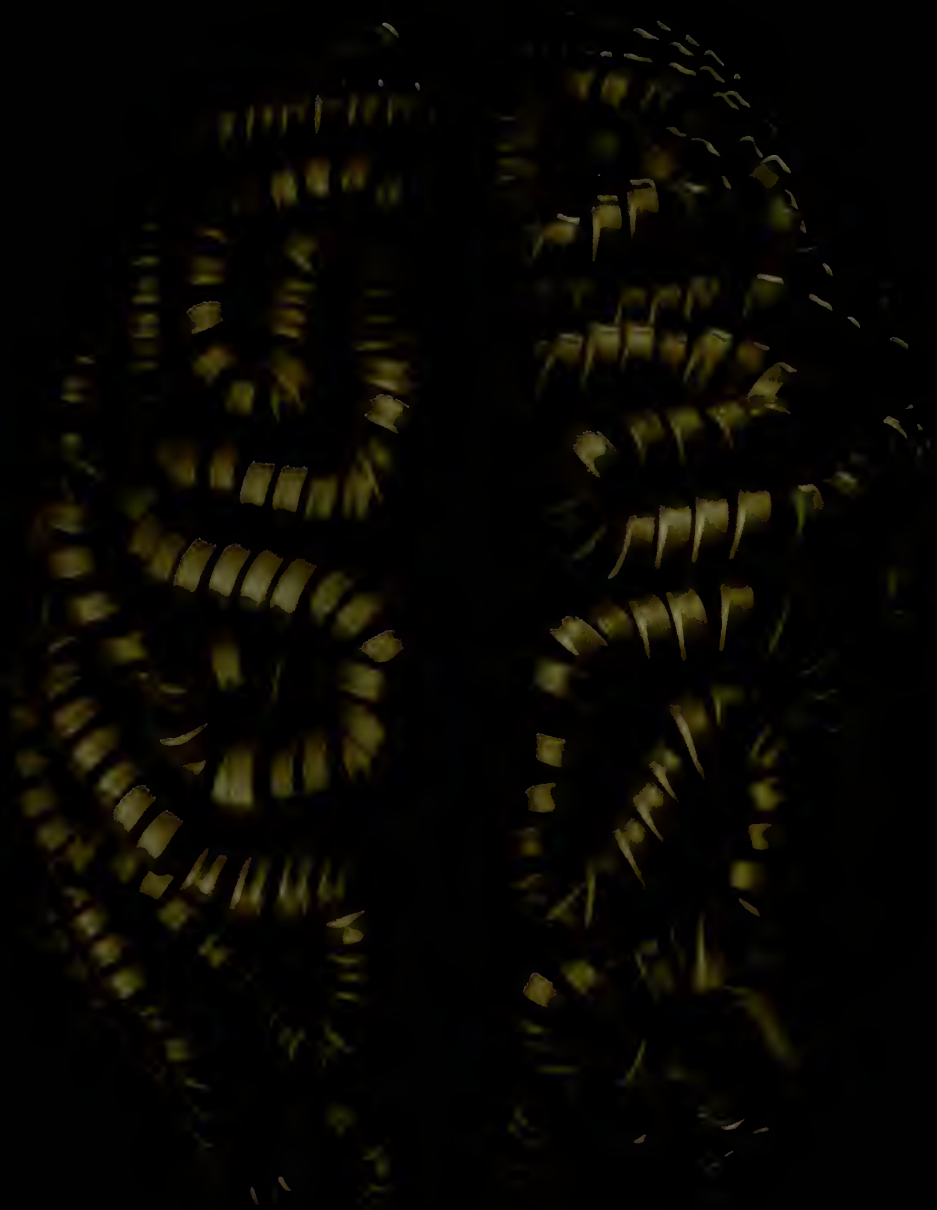
WITH LIFE EXPECTANCIES GOING UP, life insurance rates should be coming down, right? That has been the case for a decade, as term life premiums dropped by about half. But now, the industry is tightening its guidelines, and that could spell a hike of 5% to 25% for many applicants. Some insurers are raising rates outright, says Bob Barnes, president of **Compulife Software**, which provides rate comparisons.

Others are simply making it harder to qualify for their best rate. For example, **American International Group** has just lowered the weight cutoff from 221 pounds to 205 for a six-foot man, says Barney. A 40-year-old in the preferred-plus rate category would pay \$395 a year for a \$500,000, 20-year term policy, but \$490 at **AIG's** preferred level. Insurers are also getting pickier about cholesterol levels, family history of disease—even driving records, says Byron Udell, CEO of **AccuQuote**. But some good news could be in the offing. State regulators are adopting a new actuarial table that takes into account longer life spans. That could offset the rate upsurge when states adopt the new numbers next year or in 2006. —Carol Marie Crop

TIME OFF

A SPARKLING DISPLAY of gem-encrusted jewelry, watches, clocks, and pens from **Cartier's private collection** is on show at the **Museum of Fine Arts, Houston**, through Mar. 27. It's the exhibit's only American stop after a world tour that included stints in Berlin, Milan, and Kyoto. Cartier commissioned avant-garde Italian architect Ettore Sottsass to curate the exhibit and design the showcases. The 200 pieces are from the first half of the 20th century, and many adorned such notables as Gloria Swanson and Mrs. Cole Porter. —Kate Murphy





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BY ROBERT BARKER

The S&P Shuffle: Make Way for News Corp.

Who is Rupert Murdoch's next victim? Not even the shrewd mogul from Down Under knows. At 4 p.m. on Dec. 17, as the New York Stock Exchange bell clangs an end to trading, his News Corp. will join the Standard & Poor's 500-stock index. That means some unlucky company will have to make way for Murdoch.

But which one? An S&P committee of economists and analysts, which decides who joins or exits the list of 500 leading U.S. public companies, isn't telling until the week of Dec. 12. "Somebody will come out. That's all I can say," the panel's chairman, S&P Managing Director David Blitzer, told me. More than \$1.2 trillion directly tracks the S&P 500, so any change sets off a trading frenzy. That's why the name is top secret at S&P (like *BusinessWeek*, one of The McGraw-Hill Companies) and a focus of speculation.

SO LET'S SPECULATE. To start, I'll go out on a limb and bet we can omit McGraw-Hill from a list of potential outcasts. That leaves just 499 other possibilities. We also likely can eliminate companies with the highest market capitalizations, say of \$50 billion or more. As it happens, the day I checked there were exactly 50 such leaders, from market-cap giant General Electric (\$382 billion) down to Goldman Sachs Group (\$50 billion). With a \$51.6 billion market cap, News Corp. would have made this top decile were it already a member of the index (table).

News Corp. only became eligible to join the S&P 500 after Nov. 12, when it moved its corporate domicile and its shares' principal trading market to the U.S. from Australia. To make room, S&P will follow a few stated criteria. First,

companies in mergers or major makeovers are prime candidates for delisting. Companies also become vulnerable when they no longer clear the hurdles for initial inclusion, such as market value and trading liquidity. The absolute dollar value of a stock also matters. Too low a price impedes trading as some investors shun penny stocks; too high a price (think the \$84,000 a share Berkshire Hathaway recently fetched) hurts, too. Other criteria: what S&P calls "financial viability," or steady profits, and "sector balance" or keeping the list reflective of how investors value various parts of the economy.

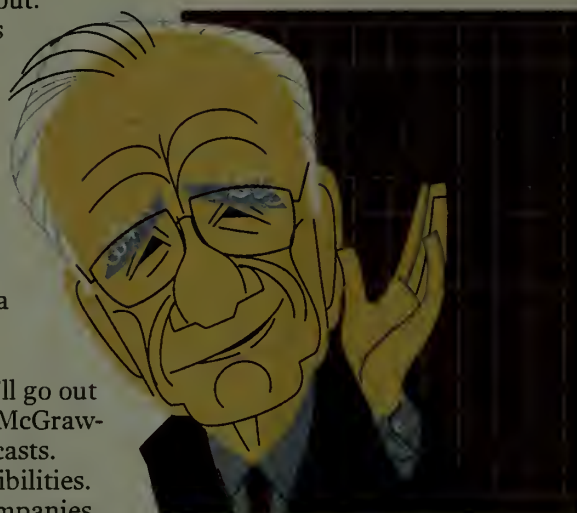
Given all this, I searched for possible casualties. PeopleSoft, which is being chased by an acquisitive Oracle, is one possibility. Sears, whose board has

approved a merger into Kmart Holding, is another. There are no obvious media stocks that News Corp. might elbow aside, but the media industry is in the economy's consumer discretionary sector and there two names stand out: Toys "R Us, which is looking to split its toy retailing unit from its Babies "R" Us furnishings and apparel chain, and OfficeMax, which joined the list as Boise Cascade. Huh? Boise bought office supplier OfficeMax in 2003 but then sold its forest-products lines and took the OfficeMax name. You have to wonder, with Staples (market value: \$15.8 billion) and Office Depot (\$5.1 billion) already in the index, is OfficeMax (\$2.7 billion) really necessary?

Then, there are those companies with stock prices below \$5. The other day, I counted seven: ADC Telecommunications, Applied Micro Circuits, Calpine, Ciena, JDS Uniphase, Lucent Technologies, and Qwest Communications International. Ciena looks particularly weak. Wall Street expects the telecom gear maker on Dec. 17 to post its 13th straight quarterly loss.

The S&P 500 might say good riddance to shamed insurance broker Marsh & McLennan if good corporate citizenship were a criterion. But it's not. The index aims to reflect the market and economy as they are. Step right in, Mr. Murdoch. ■

E-mail: rb@businessweek.com



How News Corp. Fits Into the S&P 500

Market Value	\$51.6 billion
Market Value Rank	47
Industry Classification	Media: Movies & Entertainment
Industry Peers (Market Value)	Time Warner (\$76 billion) Viacom (\$63 billion) Walt Disney (\$52 billion)
Stock Performance 2004	0.3%
S&P 500 Performance	6.0%
Symbol	NWS
Stock returns are through Nov. 29	

Data: Standard & Poor's, BusinessWeek



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BY GENE G. MARCIAL

COLGATE-PALMOLIVE: WHY THE COLD BATH PROBABLY WON'T LAST.

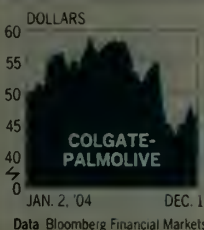
POTENTIAL IS 'HUGE' FOR GIVEN IMAGING'S DIAGNOSTIC PILLCAM.

CURIS HAS SOME NEW DRUGS THAT BIG PHARMA COULD WANT.

Brighter Smile at Colgate?

HEAVY OUTLAYS for ads, plus a jump in raw-material and fuel costs—and pricing pressure from rivals—forced Colgate-Palmolive (CL) to warn the Street in September that 2004 profits wouldn't meet forecasts. There was a scramble to bail out of the stock, sending it down from 55 to 43 in a matter of days. But not everyone is giving up: It's now at 46—"a good entry point to invest in one of the world's most brands," says Sarat Sethi of investment firm Douglas C. Lane & Associates, which has bought shares. Colgate toothpaste, soaps, and pet food are sold in 200 lands. The stock has traded at a premium vs. its peers for years, says Sethi, and this chance to buy shares as Colgate is spending heavily on ads. He expects Colgate will announce a restructuring this month as part of its profit-lifting plan. He sees the stock at 55 to 60 in a year. He expects 2004 earnings to drop to \$2.41 a share on sales of \$10.5 billion, down from 2003's \$2.46 on \$9.9 billion—but that should jump to \$2.67 on \$11.1 billion in 2005 and to \$2.95 on \$11.8 billion in 2006. William Chappell of Trust Robinson Humphrey, who still rates Colgate a buy, says it "will be rewarding to patient investors."

THE GLEAM IS OFF—FOR NOW



Given Imaging: A Camera You Can Swallow

EMBEDDED IN A PILL, a tiny wireless camera called PillCam, made by Israel's Given Imaging (GIVN), is electrifying some investors. It lets a doctor examine a gastrointestinal tract noninvasively, taking pictures to find abnormalities. "I bought Given stock fast when I learned of PillCam: It has huge potential for other diagnostic uses," such as cancer of the esophagus, says Marion Schultheis of investment outfit J&W Seligman. Shares bolted from 15 last September to 32.45 on Dec. 1. Johnson & Johnson is Given's marketing partner for PillCam. Wade King of Wells Fargo Securities, which has done banking for Given, expects revenues of \$60 million in 2004, \$86 million in 2005, and \$121 million in 2006, vs. \$40 million in 2003. On Nov. 29, the Food & Drug Administration approved an upgraded version called PillCam Pro that takes 14 frames per second instead of four. Swallowed with water, PillCam goes into the stomach, where it can spot

precancerous conditions related to acid reflux. Images are sent to a Walkman-like recorder taped to the patient's abdomen. Schultheis expects Given to earn 6¢ a share this year, 53¢ in 2005, and \$1.02 in 2006. Bernie Schaeffer of Schaeffer's Investment Research says the stock's momentum shows Given could double in a year.

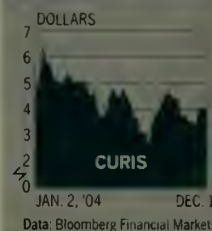
THAT FULL FEELING



Rich Suitors May Come Courting Curis

WITH THREE BIG PHARMAS—Genentech, Johnson & Johnson, and Wyeth—as its partners, tiny Curis (CRIS) is a "sitting duck" for a takeover as it develops drugs to combat a number of diseases. So say some investors who own shares but don't want to be named. They note that Curis' market cap is just \$200 million. One hedge-fund manager puts Curis' buyout value at 9 a share, or \$423 million. Its technology uses proteins or small molecules to modulate "regulatory pathways" that control the repair and regeneration of tissues and organs. Curis has come up with drugs aimed at basal cell carcinoma, with Genentech as its partner; kidney diseases, with J&J; and cardiovascular and neurological ills, with Wyeth. John Sullivan of investment bank Leerink Swann, which has done banking for Curis, rates it "outperform" based solely on its pipeline of products that, he says, the big drugmakers see as promising. He expects Genentech could file this year for FDA "new drug" approval of Curis' product for carcinoma so it can start clinical trials. Sullivan says this will boost the stock, now at 4.10, up from 2.46 in August. He figures Curis could end up with more than \$100 million in milestone payments—plus royalties—from Genentech once the drug is approved and commercialized. He expects about the same sum from J&J. Sullivan sees Curis profitable in 2008, earning \$25 million, or 50¢ a share. ■

AN INEXPENSIVE DATE



BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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The statistics are stunning. America's WETLAND is the seventh-largest delta region in the world. It's part of the second-largest flyway in the United States and the winter habitat of 5 million birds. It's also home to 79 threatened or endangered animal and plant species. And it's losing 25 square miles every year, rapidly adding to the 1,900 already lost.

America's WETLAND also houses the No. 1 port system in the world by tonnage. And it accounts for one-third of America's fisheries. One-third of the nation's oil and gas,

both foreign and domestic, traverse its waterways.

But even more stunning than the statistics is the natural beauty of America's WETLAND—and the fact that its majesty could be lost forever if nothing is done to stem the tide of devastation.

Louisiana's Governor, Kathleen Babineaux Blanco, believes that the rest of the nation is waking up to the harsh reality that every state in America is somehow connected to America's WETLAND. "Both man and nature could end up big losers if we don't act now to turn back the coastal land loss. It's destroying delicate habitat for marine and animal species vital to our seafood supply and migratory birds, jeopardizing our energy, maritime and transportation centers," says Blanco.

This invaluable landscape along Louisiana's coast is also one of America's best-kept secrets. But not for long. That's because Louisiana is engaged in a public-awareness campaign focusing on the economical, ecological and cultural impact that this land loss will have on the nation.

"It's a much more serious problem than anyone understands," says Val Marmillion, president of Marmillion & Co., the company handling strategic communications for the America's WETLAND campaign. "The purpose of this campaign is to alert the nation and

America's WETLAND

Shining a Light on an Endangered Region's Riches

the world about the tragedy in natural and economical terms."

The disappearance of Louisiana's wetlands, which could lose another 1,000 square miles by 2050, has enormous ramifi-

cations for the nation's economy. America's WETLAND offers protection to commercial fisheries, shipbuilding yards, and a vital part of the nation's oil and gas infrastructure.

In addition, the loss of these wetlands is a risk to the area's communities and their unique culture. That's why the campaign's latest venture — A Place Called America's WETLAND — promotes the region by linking its natural surroundings with the arts, culture, music, traditions and history of the people who live here.

The initiative is sponsored by Shell Oil Co., who has more than 4,000 employees operating offshore E&P facilities, major chemical and oil products manufacturing and refining plants. Shell understands that the environmental, social, and economic viability of Louisiana's coast is important to its company, the State of Louisiana and the nation. "Shell has had a long-standing commitment to environmental protection and managing our business in a way that sustains the coastal ecosystem," says Shell company spokesman Johan Zaayman. "Thus, Shell recognizes the importance of preserving America's WETLAND and is committed to raising awareness about the impact of wetlands loss and promoting support for efforts to save coastal Louisiana."

The wetlands are a prime site for a new brand of experiential



THIS WETLAND
HAS PROVIDED
PROTECTION
FOR CENTURIES.
NOW
WE'RE RETURNING
THE FAVOR.

ld eagles. Gulf fisheries. The diversity of
Louisiana's coastal wetland makes it among
the country's most valuable resources.
buffer against hurricanes and storms, this

unique area also protects a transportation network and infrastructure
that supplies a quarter of the country's energy.

For Chrystal Kain and Dr. Michael Macrander, the wetland is their
backyard, their livelihood and their passion. Chrystal is an environmental
specialist with a Shell affiliate. Michael is an environmental ecologist
with Shell Global Solutions. Together, they're fighting back against the
erosion and deterioration that claim 35 square miles a year.

The two are working with government and
community groups to develop a hydrology
model which will help determine how to
restore the area and others like it around

the world. Not only because it's their backyard and their livelihood.
But because, at Shell, it's their responsibility.

For details about this and other Shell sustainable development efforts,
visit www.shell.com and www.americaswetland.com.



Eco-Cultural Tourism—The New Adventure Experience

Launching a new era of eco-cultural tourism, Louisiana's Lt. Governor, Mitch Landrieu, welcomed the nation and world to experience "remarkable" adventures at a recent unveiling of A Place Called America's WETLAND. "In the midst of dramatic land loss across coastal Louisiana, we are calling attention to a global treasure that people must see and experience to believe," Landrieu said. "When you link Louisiana's unique culture and history, raw talent and unparalleled ecological resources, you have a place that will rival anywhere for the growing trend in experiential or adventure travel." For nature lovers and birding enthusiasts, The America's WETLAND Birding Trail along Louisiana's Great Gulf Coast will allow visitors to view and experience a vast and valuable wildlife habitat.

travel and adventure, called eco-cultural tourism. Eco-cultural tourism emphasizes the experience of exploring a place where the close ties between the people and their land has resulted in a unique culture.

"This is one of the more significant places in the United States where the ecology and the culture are so intertwined that they can't be separated," says Sidney Coffee, executive assistant to the governor for coastal activities in Louisiana. "It's a marvelous opportunity and one of the rare occasions when you can see an incredibly productive and vast ecosystem and at the same time experience one of the most robust cultures in America."

The vastness and beauty of America's WETLAND, and the diversity and richness of its cultural attractions, make it an excellent location for travelers interested in walking trails, birding, camping, recreational and sport fishing, canoeing, kayaking and more.

Key aspects of the initiative include the America's WETLAND Birding Trail, which was created to draw wildlife viewers from around the world. The trail links 115 wildlife-viewing venues and provides an organized way to understand the depth and uniqueness of the area—from its fresh water and saltwater marshes to lagoons and natural bayous, all populated by a vast array of birds and other wildlife.

America's WETLAND Resource Centers are another important component, with more than 25 in strategic tourist destinations, including gateways in Lake Charles and New Orleans. The Resource Centers are supported by knowledgeable staff and

interactive kiosks that inform visitors about the wide variety of experiences available.

While diversity is the strength of America's WETLAND, it also means it's a complex, delicate ecosystem that will take decades and billions of dollars to restore. The long-range solution is to reintroduce water and sediment from the Mississippi River to the wetlands, which were cut off when levees were built.

Groups that have often been at odds are working together to build national support for the region's restoration. "The most gratifying and refreshing part of this has been watching industry groups, national environmental groups and people from all over the country and here in Louisiana come together for this common cause," says Coffee. "It just shows that this issue is bigger than any one individual group."

The campaign hopes to create a sense of urgency among the public to experience this natural phenomenon—and keep it from disappearing. The best way to get people to feel an emotional connection to a place is to have them experience it firsthand and then share that feeling with their own communities. The result could be the level of awareness and support that will maintain the national importance—and the natural magnificence—of a place called America's WETLAND. ■ Written by Jill Colford

For more information on Special Advertising Sections contact Stacy Sass McAnulty, Director, Worldwide Special Advertising Sections at 212-512-6296, or e-mail her at stacy_sass-mcanulty@businessweek.com

Web Resources:
America's WETLAND:
Campaign to Save Coastal Louisiana
<http://www.americaswetland.com/>

Louisiana Department of Culture,
Recreation & Tourism
<http://www.crt.state.la.us>

Shell Oil Co.
www.shell.com



Personal Business Figures of the Week

OCKS

S&P 500



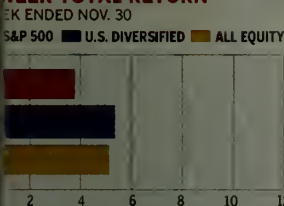
COMMENTARY

Investors snapped up tech stocks Dec. 1 after chip-equipment maker Novellus Systems surprised the market with news that sales and profits would beat forecasts. Tech-hungry investors poured into the bourses, sending SDAQ, and the other indexes, surging. And while retailers are wary, the holiday shopping outlook appears solid. Adding to the cheer: a break in oil prices.

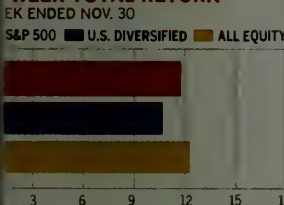
Source: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

WEEK TOTAL RETURN



4-WEEK TOTAL RETURN



Source: Standard & Poor's

U.S. MARKETS

	DEC. 1	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1191.4	0.8	7.1	11.3
Dow Jones Industrials	10,590.2	0.7	1.3	7.0
NASDAQ Composite	2138.2	1.7	6.7	7.5
S&P MidCap 400	645.7	0.9	12.1	12.1
S&P SmallCap 600	326.2	1.9	20.6	21.0
DJ Wilshire 5000	11,720.5	1.0	8.5	11.9

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	694.1	0.3	11.6	14.5
BW Info Tech 100**	365.8	1.4	4.4	7.5
S&P/BARRA Growth	572.7	0.9	3.0	6.1
S&P/BARRA Value	614.3	0.7	11.3	16.7
S&P Energy	289.6	-1.8	29.2	45.7
S&P Financials	402.6	1.3	6.0	9.7
S&P REIT	141.8	1.7	22.5	23.7
S&P Transportation	239.0	2.0	18.4	18.9
S&P Utilities	137.2	-2.9	15.9	22.4
GSTI Internet	166.8	2.8	15.3	16.9
PSE Technology	769.6	1.9	10.4	12.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	DEC. 1	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1344.3	2.8	14.0	22.5
London (FT-SE 100)	4735.7	0.3	5.8	7.4
Paris (CAC 40)	3796.7	1.0	6.7	8.8
Frankfurt (DAX)	4186.0	5.6	5.6	9.5
Tokyo (NIKKEI 225)	10,784.3	-3.1	1.0	3.7
Hong Kong (Hang Seng)	14,162.8	1.2	12.6	13.7
Toronto (S&P/TSX Composite)	9064.5	1.0	10.3	14.4
Mexico City (IPC)	12,233.9	2.7	39.1	41.9

FUNDAMENTALS

	NOV. 30	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.96%	1.95%	1.61%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.8	19.9	26.9
S&P 500 P/E Ratio (Next 12 mos.)*	16.4	16.5	18.0
First Call Earnings Revision*	-0.19%	-0.17%	-0.23%

*First Call Corp.

TECHNICAL INDICATORS

	NOV. 30	WEEK AGO	READING
S&P 500 200-day average	1122.4	1122.0	Positive
Stocks above 200-day average	75.0%	76.0%	Negative
Options: Put/call ratio	0.63	0.64	Neutral
Insiders: Vickers NYSE Sell/buy ratio	5.73	5.50	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Steel	26.6	Internet Retail	99.7
Managed Health Care	23.0	Steel	87.2
Tires & Rubber	17.1	Internet Software	71.6
Tobacco	17.1	Wireless Services	68.9
Agricultural Products	15.7	Oil & Gas Refining	67.2

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Computer Stores	-3.3	IT Consulting	-29.8
Hypermkts. & Suprcntrs.	-1.5	Insurance Brokers	-27.7
Motorcycles	-1.3	Semiconductor Equip.	-26.6
Gas Utilities	-0.7	Semiconductors	-25.1
Instrumentation	-0.3	Airlines	-14.3

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Natural Resources	10.3	Natural Resources	45.5
Precious Metals	8.8	Latin America	37.7
Latin America	8.2	Real Estate	28.1
Small-cap Value	7.7	Utilities	26.0
LAGGARDS		LAGGARDS	
Domestic Hybrid	2.6	Precious Metals	-5.3
Japan	3.2	Technology	-0.5
Financial	3.6	Health	5.5
Large-cap Blend	4.0	Small-cap Growth	5.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Fidelity Sel. Mdc. Del.	19.2	ProFunds Energy Utr. Inv.	78.1
ProFds. Ult. Sm. Cap Inv.	17.2	ProFds. Wrlls. Ultsr. Inv.	76.9
State St. Rsch. Gl. Rs. A	16.5	State St. Rsch. Gl. Rs. A	69.9
U.S. Gbl. Invs. Gl. Rscs.	14.6	iShares MSCI Austria Idx.	68.4
LAGGARDS		LAGGARDS	
ProFds. USh. Sm. Cap Inv.	-15.0	ProFds. Smicdr. Ultsr. Inv.	-42.6
ProFds. USh. Mid Cap Inv.	-11.0	Thurlo Growth	-38.7
Rydex Dyn. Vent. 100 H	-9.8	Ameritor Investment	-36.1
ProFunds UltSh. OTC Inv	-9.8	Rydex Electronics Inv.	-27.7

INTEREST RATES

KEY RATES

	DEC. 1	WEEK AGO	YEAR AGO
Money Market Funds	1.50%	1.46%	0.62%
90-Day Treasury Bills	2.21	2.17	0.93
2-Year Treasury Notes	3.00	3.01	2.07
10-Year Treasury Notes	4.36	4.19	4.40
30-Year Treasury Bonds	5.01	4.84	5.19
30-Year Fixed Mortgage †	5.75	5.68	5.97

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.67%	4.60%
Taxable Equivalent	5.24	6.57
Insured Revenue Bonds	3.85	4.71
Taxable Equivalent	5.50	6.73

THE WEEK AHEAD

FALLMENT CREDIT Tuesday, Dec. 7, 3 p.m. EST » In October consumers probably added another \$6.5 billion to their credit, following a September increase of \$9.8 billion. That's according to the median forecast of economists surveyed by Action Economics.

PORT-IMPORT PRICES

Thursday, Nov. 9, 8:30 a.m. EST » Export prices are forecast to have risen by 0.4% in November,

after a 0.7% jump in October. Import prices most likely grew at a 0.4% clip as well, after a 1.5% gain in the prior month. A retreat in petroleum prices to below \$50 per barrel in November is the main reason for the moderation in import prices.

PRODUCER PRICE INDEX Friday, Dec. 10, 8:30 a.m. EST »

October producer prices are expected to have edged up by 0.1%, after a 1.7% energy-related

surge during October. Excluding food and energy, core prices most likely grew by 0.2%, after a moderate gain of 0.3% in October.

FEDERAL BUDGET Friday, Dec. 10, 2 p.m. EST »

The federal government will probably report a \$50 billion deficit for November, after a \$57.3 billion shortfall in October, the first month of the 2005 fiscal year. In fiscal 2004, the total budget deficit hit a record \$412 billion.

The *BusinessWeek* production index climbed to 231.8 for the week ended Nov. 20, a 10.8% gain from the previous year. Before calculation of the four-week moving average, the index jumped to 233.4.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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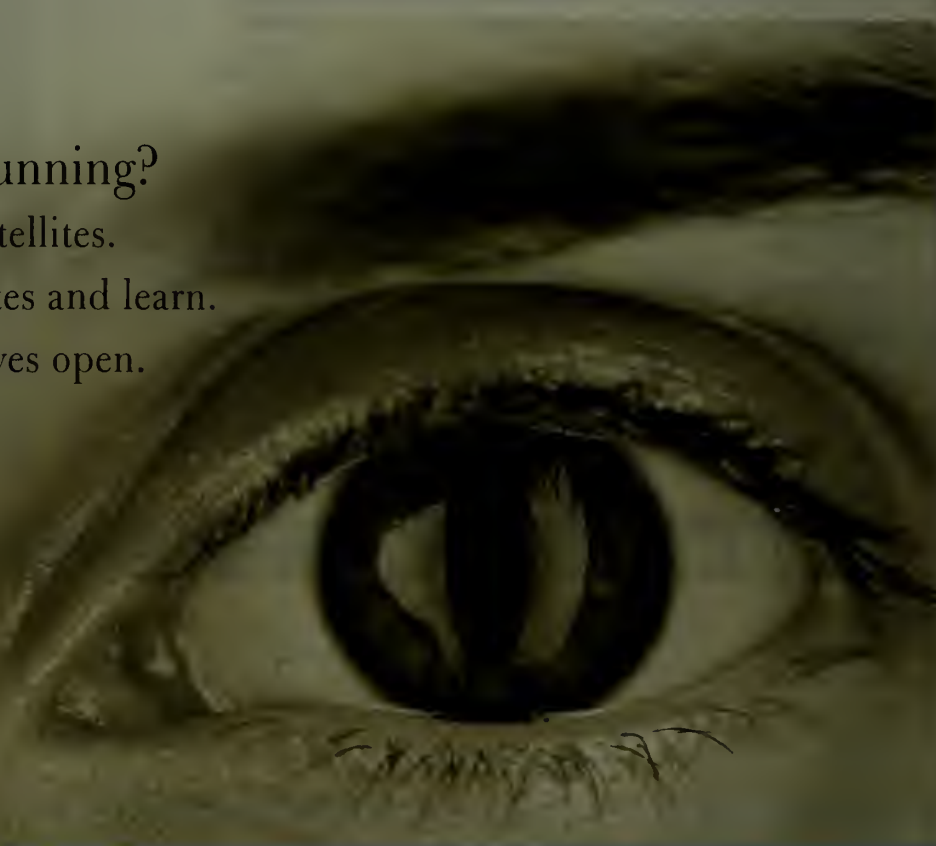
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What keeps the world running?

Jet engines that talk to satellites.

Elevator systems that take notes and learn.

Locks that only your eyes open.



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Social Security: No Flim-Flams

KELLOGG CO. CEO Carlos M. Gutierrez is joining President Bush's new economic team as Secretary of Commerce. He will help sell Congress and the American public on the idea of partially privatizing Social Security. We hope that Gutierrez insists that the high standards of financial honesty and transparency that marked his years at Kellogg be applied in the public realm. The recent proposal to take the \$1 trillion to \$2 trillion 10-year cost of reforming Social Security "off-budget" and not include it in the federal budget deficit is as irresponsible as it is dangerous. An Administration that in its first term fought against the hidden government backing of Fannie Mae mortgage securities should not in its second hide the true borrowing cost of adding private accounts to Social Security.

The idea of Social Security private accounts is hugely popular among the young who want to control more of their own retirement financing. The problem is that diverting two to four percentage points of employees' 6.2% payroll taxes to privately owned accounts deepens Social Security's financial

hole. The system must still cover its obligations to current retirees and soon-to-retire baby boomers with less revenue flowing in.

The President's advisers are telling him to just borrow the trillion or two to cover the cost of transition to private accounts. A number advise him to go further and not include the huge new debt in calculating the nation's annual budget deficit. They suggest that the cost of the private account be treated as a prepaid benefit for future retirees not as a present-day expense. They also say that borrowing for a decade or two to reform Social Security will make it solvent 30 to 40 years down the road. Therefore the cost of transition should be considered outside normal 10-year budget calculations and should be placed off-budget.

**Hiding
debt with
gimmicks
will only
make things
worse**

We say a banana is a banana and debt is debt no matter how you stretch to define it. As scandal after accounting scandal in Corporate America has shown, flim-flamming balance sheets through gimmicks such as Special Purpose Entities can lead to disaster. Nervous bond markets, rising interest rates, and a weaker dollar abroad may already be signaling concern about talk of hiding trillions in new government borrowing. If we are going to change Social Security, let's talk about the real issues—trimming benefits, raising the retirement age, and, above all, calculating the cost—openly and honestly.

Easing the Dollar Dilemma

WE APPEAR TO HAVE a dollar crisis every 10 years. We had one in the mid-1970s, one in 1985, and one in 1995. Is another looming for 2005? After smoothly falling 25% on a trade-weighted basis for two years since its peak in 2002, the dollar hasn't crashed yet. But currency markets tend to overshoot, and there's a good chance that the dollar will hit its low for this cycle next year, perhaps with a thud loud enough to require intervention by central banks. Certainly the growing uncertainty about the size of future federal budget deficits makes a sharp, hard landing all the more likely. Recent reports about the Chinese buying fewer Treasury bonds sent both the dollar and bond prices down (page 52). But before we panic about the dollar, let's focus on what is real and what is not.

First, it is true that over the past 12 months, foreigners

bought a huge \$839 billion of American securities. It is also true that nearly all of the \$381 billion of U.S. Treasuries sold were purchased by the central banks of Japan and China. What is lost in the conversation about the dollar is that private investors from overseas also purchased \$297 billion of corporate bonds over this period, and some \$203 billion of government agency bonds were sold, mostly to private institutions and individuals. So about half of the current account deficit is being financed by private interests investing in the future growth, productivity, and profitability of the U.S. economy. This is very good news.

The bad news is that the dollar probably has 10% to 15% more to drop and that it is falling mainly against the euro and the yen. The Chinese yuan remains pegged to the dollar and is declining in tandem with it. This linkage is promoting growth in both the U.S. and China as the dollar and yuan fall together against the euro and yen. But it also distorts the market mechanism for redressing America's current account deficit. A third to half of the U.S.'s total trade deficit is with China, and the peg prevents the market mechanism from working to improve it. In the end, the yuan will probably be forced to rise 20% to 30% against the dollar. But the longer Beijing waits to begin the process, the more abrupt and disruptive the jump may be for both the yuan and the dollar.

If policymakers want to avoid a dollar crisis in 2005, they should attend to the one link in the currency market chain that is the weakest. And that is the dollar-yuan peg.



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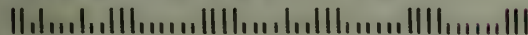


THE REAL PROBLEM

The good old days weren't as good as you thought. That's one more reason Coke's latest CEO needs a bold new formula.

BY DEAN FOUST (P.76)

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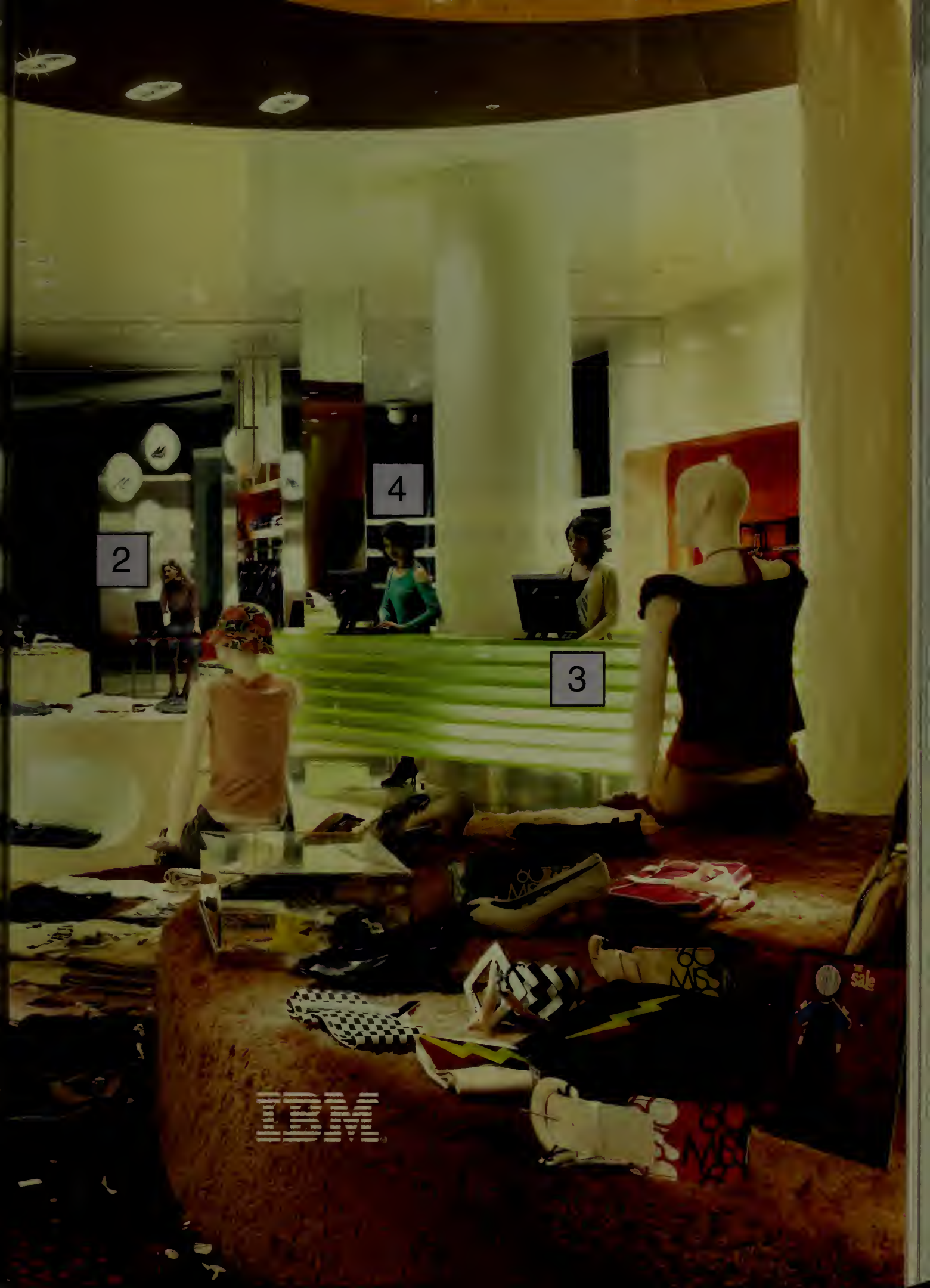
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GOIZUETA'S GHOST

The Coke machine is badly out of order. Can it rethink a model sacred to the memory of its late, fabled CEO?

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76 Coke: Gone Flat

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Amazon.com's Jeff Bezos has made online shopping faster, easier, and more personal than traditional retail



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Special Report: The Rush to Consumer Electronics

Lured by its faster growth, industry players are piling in—and they're not alone. After an upwelling of innovation could come a wave of consolidation. Plus: Microsoft's strategy; chasing iPod; and more



No Holiday Punch for Chain Stores

Disappointing Christmas sales suggest consumers aren't in a real spending mood, according to Standard & Poor's economists David Wyss and Beth Ann Bovino. Overall, though, S&P still sees the economy growing at a steady pace

IBM Chief Sam Palmisano's Many Messages

Selling Big Blue's PC unit is a strong statement to employees about the future of their company. But it also says a lot about where the tech industry, and even Corporate America, is headed



Not Everyone Buys Tesco's Strategy

Britain's No. 1 grocer has been pleasing investors lately, turning in great results. However, its aggressive pricing doesn't sit well with suppliers like dairy farmers, and it's feeling the heat from preservationists worried its stores will change the face of village life

Shawn Fanning Is Playing A New Tune

The Napster founder is back with a new startup called Snocap. Its ambitious goal is to create a digital music world where all parties can profit



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"Let me state clearly that there are no free lunches here."

—N. Gregory Mankiw, chairman of the Council of Economic Advisers, warning that Social Security overhaul must include changes in benefits for future generations

ED BY IRA SAGER

NCHOS

PHIL KNIGHT KICKS OFF HIS NO SHOES

CO-FOUNDER Phil Knight, surprised employees and stores when he disclosed Nov. 18 that **S.C. Johnson & Son** Chief Executive William W. Johnson, 57, would take over as CEO of the Beaverton (Ore.) shoe and apparel goliath. In an interview with *Entrepreneur* Stanley Johnson, Knight, who remains chairman, talks about stepping down and why Johnson, who ran a household products company, has the right skills.

giving up the CEO post at 40 years:

"The timing came together. It had been on my mind, and the board has been on me to find a successor. We looked inside and outside the company. Over the course of the years, the [search firm] had up 75 résumés.

choosing outsider Perez:

"His performance by every measure was first-rate. He was a smaller company than Nike, but it was more complicated. He was doing multiple brands in multiple countries. Nike's other brands are growing and are going to be a much more complicated piece of the puzzle. He integrated three acquisitions. And he did that very well. At the same time, it was not about his accomplishments: He is a well-beloved figure on

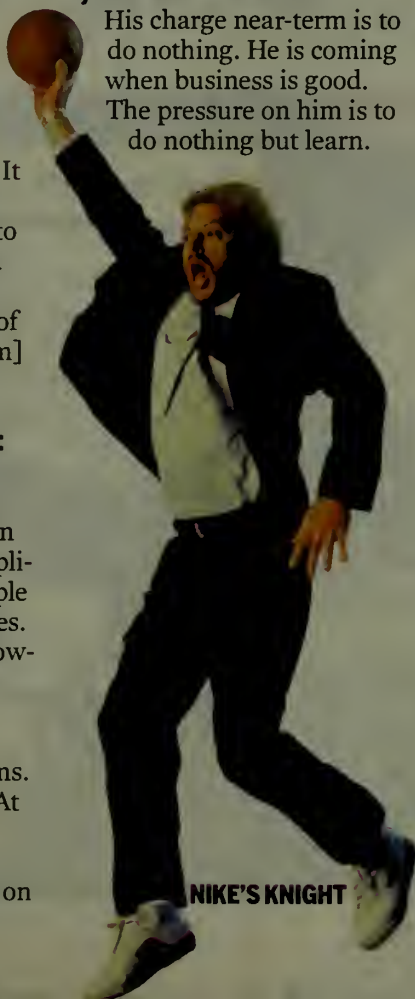
[the S.C. Johnson] campus.

On Perez' being able to mesh with Nike's insular culture:

"I was very concerned about any candidate from the outside. It's a very different culture. The most difficult time will be his first six months. There will be a little bit of a bumpy period, but I think it will work out. I'm committed to making it work. He's a fast study. He's acutely aware of the [cultural] difference. He has the capacity to listen and the ability to subdue his ego. Most CEOs don't.

On Perez' first task when he joins Nike on Dec. 28:

"His charge near-term is to do nothing. He is coming when business is good. The pressure on him is to do nothing but learn.



NIKE'S KNIGHT

ON DECK
Al Franken



RADIO DAZE

Air America Gets A Second Wind

JOHN KERRY MAY HAVE come up short, but liberal radio network **Air America Radio** is trying not to go the way of the Massachusetts senator. Despite a rocky 2004 in which AAR lost its Los Angeles and Chicago affiliates and saw nationwide Republican election wins, the network now has 40 stations in 23 states—six of them "red states"—and channels on **XM** and **Sirius Satellite Radio**. Five new affiliates joined after Nov. 2.

More welcome news: On Dec. 8 the fledgling network announced \$13 million in new financing and said that Rob Glaser, the **RealNetworks** chairman who's a longtime investor, would be AAR chairman, too. Ad revenues in November, after the election letdown, were the best yet, says President Jon Sinton (he won't provide numbers). But the proof in AAR's staying power comes in January, when **Arbitron** posts quarterly ratings.

Overall, AAR hosts still trail far behind conservatives such as Rush Limbaugh. But Glaser says liberal talk radio can work: "Al Franken crushes Bill O'Reilly head-to-head." Of course, Franken's in a fraction of O'Reilly's markets. Franken, on for three hours a day, has re-upped for a multiyear deal. It looks as if he'll have the chance to honor the whole contract.

—David Kiley

ILL WINDS

THE CO-PAY? DEPENDS WHO THE DOCTOR IS



HERE'S ANOTHER REASON to choose a doctor carefully. Thanks to an increasingly popular system known as tiering, you could have a higher co-payment if your insurance company decides you have passed over other, more efficient health-care providers in favor of your doctor. As they have done with generic and name-brand drugs, employers and insurers have begun to rate doctors and hospitals according to "efficiency" (read: high quality at a low cost) and offer an associated sliding scale of co-pays. The higher the efficiency rating, the lower the co-pay.

Such plans are on the rise. Already, **Tufts Associated Health Plans** offers tiered plans to 70,000 Massachusetts state workers, and **PacifiCare Health Systems** in Southern California offers them to 19 employers. **Leapfrog Group**, a coalition of large health-care buyers, counts seven others that offer the plans, and CEO Suzanne Delbanco says as many as 20 insurers are developing them.

Rick Siegrist, CEO of consultancy **HealthShare Technology**, says two major national insurers will offer tiered plans in 2005, but he won't disclose which ones.

Under the Tufts plan, patients are charged co-payments of \$200 per hospital admission if the hospital ranks in the top tier in quality of care and cost-efficiency for the particular service—and \$400 if the hospital is in the lower tier.

Physicians and hospitals fear the practice could unfairly penalize practitioners and say there's no way to benchmark quality accurately. "We're in favor of diminishing costs, but we think this is the wrong approach," says Dr. John C. Nelson, president of the **American Medical Assn.** Whether they will improve quality or lower costs is up for debate, but as long as health-care costs are soaring, tiered health plans will increase.

—Amy Tsao



EX LIBRIS

CRACKING THE CODE The *Da Vinci Code* is selling so well in hardcover that publisher Doubleday is in no hurry to bring out a paperback edition in the U.S. Softback versions often take up to a year, but it has been an even longer wait for the best-selling religious mystery, which made its debut in March, 2003, and has sold 1 million copies. **Doubleday says it still has no plans for a U.S. paperback.** But impatient bookworms can get an English copy, which appeared overseas earlier this year. It's printed in the U.S. but sold only abroad. No plans for foreign travel. Then hit British site amazon.co.uk, where it sells for £4.89—about \$9.50.

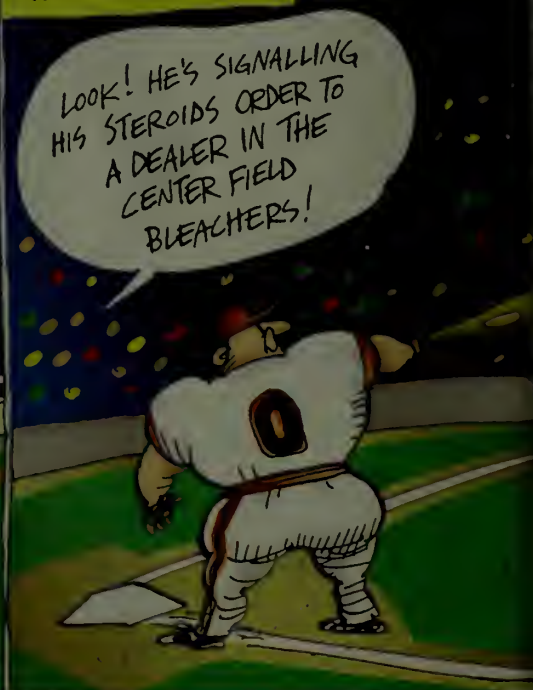
—Chester Daws

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FACE TIME
**STEVEN
OESTERLE**

SPREADING RUDY'S STARDUST

Rudolph Giuliani may have grabbed headlines for his new investment bank. But the guy who'll be running it maintains a considerably lower profile. Giuliani has tapped **Steven Oesterle**, former Ernst & Young vice-chairman, as CEO of Giuliani Capital Advisors.

The boutique bank—which focuses on restructurings and mergers and acquisitions—was created by consultants Giuliani Partners' acquiring E&Y's banking unit. The move broadens Giuliani Partners' scope: Now it can not only advise clients on M&A but also carry it out. The former mayor won't be involved in the day-to-day doings, but Oesterle will use the Giuliani stardust to land business. "Rudy's image and role will be important," he says.

Oesterle, 51, joined E&Y in 1975 as an auditor, eventually rising to vice-chairman. There he met Giuliani, who got a financial and logistical lift from E&Y in starting his consulting business. Quite a turn for Oesterle: a banker working for a former client who first made his name prosecuting **Michael Milken**. —*Brian Hinde*

OVER THERE **LES CHINOIS LOVE PARIS, TOO**

FOR EUROPE, it's the Year of the Chinese Traveler. Some 900,000 mainland Chinese have poured into the Old World in 2004. Until recently only Chinese businesspeople and students were granted European visas. But last year, Germany made it onto Beijing's list of approved tourist destinations, and on Sept. 1, China added 26 other European countries.

The first stop is often Paris, where hoteliers, retailers, and purveyors of luxury goods are set to welcome 40% more mainland Chinese next year. "They are now our No. 1 foreign customers—ahead of the Japanese," says Jean-Michel Hallez, head of prestigious **Galleries Lafayette**

department store on Boulevard Haussmann. Jeweler and watchmaker **Cartier** recently began hosting private soirées for groups of Chinese clients at its main Paris store, while hotel chain **Accor** is proving popular by offering Chinese-speaking reception staff, congee (rice porridge), and Chinese TV channel **Phoenix**.

Since nearly all Chinese tourists travel in organized groups, some European companies are hiring sales staff in China to market to tour agencies. In exchange for a promise that the groups

will swing by its Paris outlet, French department store **Printemps**, for example, helps the agencies book restaurant tables and boat tours in the City of Light.

Germany is also pitching to be on Chinese itineraries. Bavaria's tourist board persuaded a Shanghai TV station to film a documentary on the state that aired in April. And in July the board launched a Chinese-language Web site. The result: 120,000 Chinese tourists this year, up 64% from 2003. Say, what's the Chinese word for bratwurst? —*Rachel Tipler*

The stapler that snared the highest bid—\$4,101—belonged to Paris Hilton of home-sex video and reality TV fame. Actress Jennifer Love Hewitt shared second place with Bill Gates: Each of theirs garnered \$3,005.

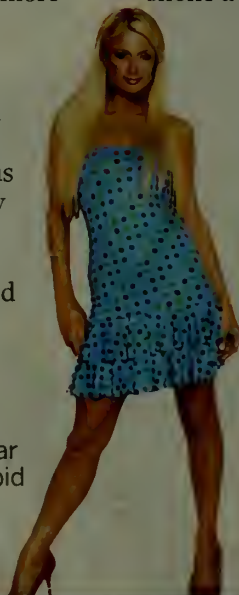
Other business luminaries shone a bit less brightly. A stapler that was signed by Ben Cohen, co-founder of ice cream maker **Ben & Jerry's**, sold for a mere \$75. (The company notes it was a late addition.) And Staples Chairman Thomas Stemberg's entry fetched just \$505. Perhaps they should pitch the networks to cast them on a reality show. —*Olga Kharif*

CHARITY CASES **FOUR GRAND FOR A STAPLER?**

A FUND-RAISING auction mounted by office-supply chain **Staples** raised more than \$50,000—but could wind up puncturing egos.

Staples auctioned off 146 staplers signed by the famous to benefit the charity of the signer's choice. The online auction, which ended on Dec. 6, shows who's hot—and who's not—among autograph hounds.

HILTON The reality star bagged the biggest bid



THE STAT

3.5

The average percentage raise in employee salaries in 2004, the same as in 2003—and the third straight year raises have not grown. Next year may bring better news, with salaries expected to rise by 3.6%.

Data: Strategic Consulting

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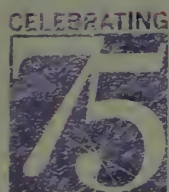


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As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

The Wizard of Web Retailing

AS A PRESCHOOLER, Jeffrey P. Bezos displayed an unmatched single-mindedness. By his mother's account, the young Bezos got so engrossed in the details of activities at his Montessori school that teachers had to pick him up in his chair to move him to new tasks. It's a trait that goes a long way toward

explaining why the company he founded, Amazon.com Inc., has survived to become the most dominant retailer on the Internet.

It was Bezos' attention to detail in 1994 that made him realize that commerce soon would change forever. A Princeton University electrical engineering and computer-science grad who grew up in Houston and Miami, Bezos was investigating potential new businesses for hedge fund D.E. Shaw & Co. in New York. He noticed that the number of people on something called the World Wide Web was growing 2,300% a year. A few months later he and his wife MacKenzie hopped in a Chevy and drove across the country to start an online bookstore in Seattle. Says Paul Saffo, research director at think tank the Institute for the Future: "Jeff Bezos was the first one to figure out what the power of the Internet was for selling."

Just as important, he was one of the few dot-com leaders to understand that sweating the details of Internet technologies would make all the difference. Amazon wasn't the first store on the Web. But Bezos beat rivals in inventing or rolling out new Internet technologies that made shopping online faster, easier, and more personal than traditional retail. He offered customized recommendations based on other buyers' purchases, let people buy an item with just one mouse click, and created personalized storefronts for each customer.

Almost since Amazon.com debuted in July, 1995, Bezos has endured the slings of skeptical analysts and the arrows of ferocious competitors. After the dot-com crash of 2000, many

Jeff Bezos made online shopping faster and more personal than a trip to the local store

people questioned his company's ability to survive. Yet this year Amazon is expected to notch its second straight profitable year selling \$6.8 billion worth of everything from books to DVD players to miter saws. Moreover, it enables thousands of other merchants, from individuals to the likes of Target Corp., to sell items on Amazon.com. That's turning it into more of a marketplace à la eBay Inc.

Bezos has long aimed to make Amazon more than just a store that happens to sell online. The lower cost of operating on the Web, sans stores and clerks, has helped it rewrite the rules of retail. Instead of depending solely on mass-market blockbusters, Amazon can make money on countless niche products that physical stores can't afford to stock, including once-obscure books such as mountain climbing narrative *Touching the Void* or that hard-to-find Peg Perego stroller. Says Amazon director John Seely Brown, a visiting scholar at the University of Southern California's Annenberg Center for Communication: "Traditional retailers can't do this."

Ultimately, Bezos, 40, wants to create something that transcends his own company. He points to Sony Corp., whose co-founder, Akio Morita, aimed to make Japan known for quality. For his part, Bezos wants to set new standards for providing a great customer experience. If he can pull that off, he will deserve an enduring place in the history books. ■

—By Robert D. H.





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A New Hand at the Hel

DEAR READERS: It is my pleasure to announce that Stephen B. Adler will be my successor as editor-in-chief of *BusinessWeek*. Steve, who is deputy managing editor of *The Wall Street Journal* and editorial director of its online edition, will officially take over on Apr. 1, 2005.

Steve brings a unique array of talent and experience to the job. He is, first of all, a strong, creative editor who has managed many big projects at the *Journal*, including three that have won Pulitzer prizes. In addition, he has had direct oversight of the *Journal's* online operation, experience that will help *BusinessWeek* develop its own digital strategy.

Not least, Steve is also a terrific person—decent, thoughtful, witty, full of ideas, and a good listener. After 20 years in this job and 32 years at the magazine, I am leaving with mixed emotions, but I am most confident that Steve will continue to make *BusinessWeek* the world's premier business magazine. "I am really excited about this opportunity," he says. "*BusinessWeek* is a terrific magazine and news organization. I see enormous potential to do even greater things."

A native of Queens, N.Y., who grew up on Long Island, Steve, 49, is a graduate of Harvard University and Harvard Law School. Determined to be a journalist, he started as a reporter for the *Tampa Times* and the *Tallahassee Democrat*. In 1983 he joined *The American Lawyer*, rising to become its editor. In 1985 he was a finalist in the National Magazine Awards for his article in *The American Lawyer* on the Union Carbide accident in

Bhopal, India. His book, *The Jury: and Error in the American Courtroom*, won the American Bar Assn.'s Silver Gavel Award in 1995.

Steve joined *The Wall Street Journal* in 1988 as its legal editor. He was appointed to the Page One staff as

special projects editor in 1994 and was named deputy Page One editor in 1997. Two years later he became deputy managing editor of the newspaper, overseeing among other things the Web site and books imprint.

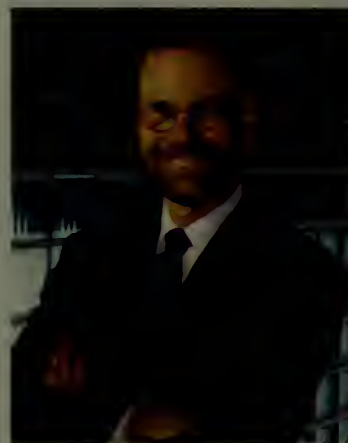
Steve and his wife, Lisa Grunwald, a novelist, live in New York City with their children, Elizabeth, 8, and Jonathan, 8.

Before I embark on my own new journey as the founding dean of the Graduate School of Journalism at the City University of New York, I will spend three months working closely with Steve to ensure a smooth transition. Adds Steve: "I have a great opportunity to...listen to all the ideas from the people on staff."

I'm sure he will be a great editor. Bon voyage, friend.

Stephen B. Stephan

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Giving money to the arts, environmental issues, poetry, and science hardly qualifies as charity"

—Bob Leake
New London, Pa.



PHILANTHROPY: WHO ARE THE REAL BENEFICIARIES?

YOUR ARTICLE ON "The top givers" (Special Report, Nov. 29) and specifically the table on "How corporations hand it out," showing corporate gifts as a percentage of revenues, does not give a true picture of corporate giving. A better method would be to compare a company's donations with its pretax or aftertax income. The list as you have it does not take into account expenses, the cost of goods sold, and thus margins. Reconfigured, it would show a completely different picture as to who donates the largest share of their wealth.

—Ken Swanstrom
Danboro, Pa.

WHY WOULD YOUR magazine measure corporate giving both for cash and in-kind contributions as a percent of gross revenue? Within various industries, there is a big difference in the profit on sales dollars. May I suggest contributions per net earnings or even contributions per employee?

—Jerry B. Jackson
Heber Springs, Ariz.

PHILANTHROPY? CHARITY? These are the terms used by the writers of this article, but maybe the terms "notoriety" and "tax deductibility" should have been used. Of the 50 most generous philanthropists, only a few gave to true human needs.

None that I saw gave to world hunger, only one to poverty, and one to the home-

less. Giving money to the arts, environmental issues, poetry, and science hardly qualifies as charity, but more as donations to special or personal interests.

—Bob Leake
New London, Pa.

MY GRANDMOTHER wasn't as rich as William H. Gates III. A widow most of her life with three children to care for and enjoying a minimal widow's pension, she was nevertheless more generous than Gates and his fellow philanthropists ever will be.

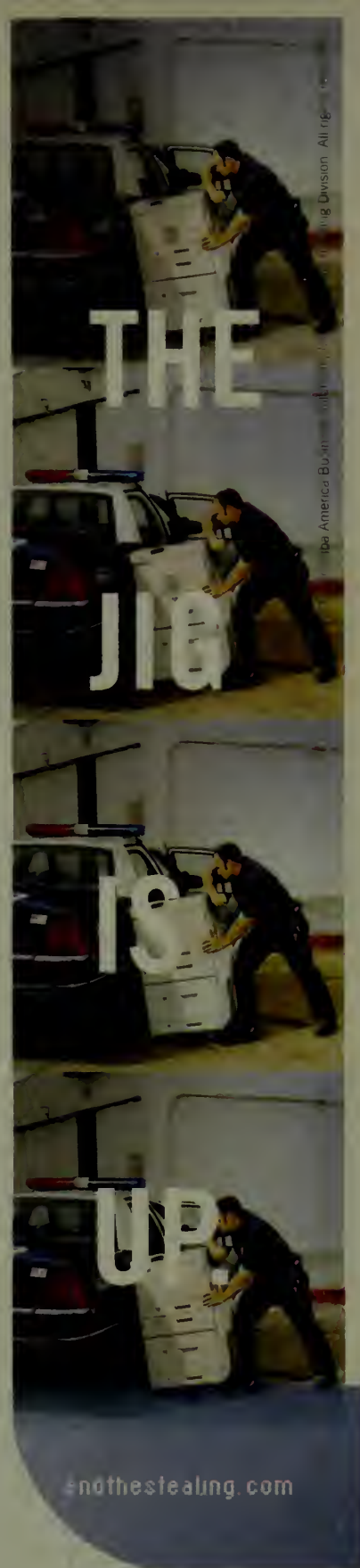
—Marcel Hendrickx
Brussels

WELL DONE ON your Special Report: Philanthropy 2004. But after all that research, how could you possibly have missed Arnold O. Beckman, who died this past May at age 104 after giving about \$400 million to science and education? He changed the world with his introduction of electronics into chemistry, and he leaves a charitable foundation of nearly \$500 million dedicated to distributing funds for scientific research in perpetuity. It makes a wonderful story with global impact.

—Jerry Gallwas
Fullerton, Calif.

Editor's note: *BusinessWeek* includes only living donors in its Top 50 ranking.

ONE VERY IMPORTANT element is missing from the report: Money spent on phi-



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CORRECTIONS & CLARIFICATIONS

"Why the dollar is going way" (News: Analysis & Commentary, Dec. 6) incorrectly identified Nouriel Roubini as a professor at Columbia University. He's at New York University's Stern School of Business.

"Why consumers hate mergers" (The Corporation, Dec. 6) incorrectly stated the cost to consumers of bank mergers. It should have said that if each household affected by such a merger spent an hour dealing with the aftereffects of the merger, the total value of that time at the overall average wage rate would be roughly \$900 million.

Because of a production error, the final sentence in "Cholesterol: The bigger the better" (Personal Business, Dec. 13) was cut short. The complete sentence reads: "When it comes to cholesterol, a long walk beats a short run."

Philanthropy comes also from manufacturing workers whose working and often living conditions are disastrous and who do not get a living wage. Manufacturers should treat their workers decently instead of taking out "social insurance" with their philanthropy.

—Marie-Claude Hessler
Paris

I HARDLY BELIEVE that giving a large amount of money to your own foundation is philanthropy. It becomes charity only when the funds are used to improve the condition of those in need. Paying high administration costs to manage a foundation is not charity.

—Jerry Steakley
Orlando

IN "ORDINARY PEOPLE, extraordinary gifts" (Special Report, Nov. 29), I was somewhat troubled by the line "there are those motivated by a sense of guilt, while others may follow a purely capitalistic calling for many years, only to be moved by a midlife wake-up call to do good." When did a capitalistic calling need a "wake-up call" to do good? If I am not mistaken, most of those folks listed as gargantuan givers relied on capitalism for their wealth and worth in the first place.

—David Simpson
Marshall, Tex.

IN YOUR ISSUE, you talk about kidney donation, and how only 242 people have given their kidneys to strangers since

1998. I inherited two bad kidneys, and have about 15% of normal kidney function. I'm approximately No. 80,000 on the United Network for Organ Sharing transplant list. The wait for a cadaver kidney is six years. Getting awareness to the public is a priority only for a few small groups. Everyone will die, and one person can help 50 organ and tissue recipients.

—Robert Berend
Kensington, Calif.

GM: LEAVING DAEWOO DRIVERS OUT IN THE COLD?

I WAS INTERESTED to read "Daewoo: GM's hot new engine" (Asian Business, Nov. 29) on General Motors Co.'s enormous success with the assets it purchased from Daewoo in 2002. This story neglects to mention that GM's windfall comes at the expense of thousands of Daewoo automobile owners in the U.S., as well as Daewoo's former dealer network.

Even though GM essentially bought an entire auto company and is profiting nicely from that purchase, GM structured the deal in such a way that Daewoo owners were cut off from all service and replacement parts for over a year. Even today, parts and service are hard to get, although GM is selling virtually identical cars under the Chevy nameplate.

GM sought to rationalize its business by eliminating brands and thus was motivated to end the Daewoo dealer network. While I have sympathy for those businesses that lost everything, I'm more sympathetic to people who, like me, purchased a Daewoo in good faith and who received numerous mailings suggesting that GM would assume responsibility for all warranty service, and that Daewoo would in fact become an arm of GM.

—Mark Bauer
St. Petersburg, Fla.

PRESIDENT MCKINLEY HAD IT RIGHT

YOUR EDITORIAL "Just say no to more spending" turns a blind eye to why our trade deficits caused 90% of our federal debt (Editorials, Nov. 22). Based on a conservative 3-to-1 ripple multiplier effect and the prevailing 50% federal, state, and local marginal tax rate, had the goods represented by our \$600 billion trade deficit this year been produced in America, they would have generated \$300 billion in added tax revenue for state and local agencies and \$600 billion for the federal treasury. Foreign workers don't pay taxes in America; only American workers do. President William McKinley said: "If you want cheap labor, cheap

prices, cheap products, you will get cheap country." To which I would add: "bankrupt country."

—Gus R. Stelz
Mill Creek, Wash.

THANK THE AMEX FOR ITS MANY INNOVATIONS

RE "THE AMEX: Worth more dead than alive?" (Finance, Nov. 29): Anyone who says the "Amex as an institution lost its reason for being long ago" needs a reminder about the innovations of the American Stock Exchange: ETFs, Spiders, Diamonds, QQQs, and, equally important, liquidity and capital-raising assistance for many small companies.

—William Silver
New York

RADIO AND BROADBAND: CROSSED SIGNALS

THE NATIONAL ASSOCIATION for Amateur Radio has participated in testing in number of the broadband-over-powerlines (BPL) marketing trials and has seen interference to radio reception in each of the sites that its staff and volunteers examined ("Easy broadband—and smarter power," Science & Technology, Nov. 22).

Your article also did not address the reverse problem of interference to BPL by licensed, legally operating radio systems. Tests carried out by amateur radio operators show that even a few watts of transmitter power nearby can cause the BPL system to stop working temporarily. Amateur radio operators are not against BPL. Instead, they oppose the pollution of wide areas of the radio spectrum by interference from BPL.

—Allen Pitt
Media and Public Relations Manager
National Association for Amateur Radio
Newington, Conn.

How to reach BusinessWeek

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BY STEPHEN H. WILDSTROM

Playing Music Is Enough, Fellas

A big reason for the success of Apple Computer's iPod is that it's designed to do one thing—play music—really well. I recently had a look at the newest iPod and some of its hard-drive-based competitors and quickly came to the conclusion that the product that does least does it best. Extra functions are nice, but they come at a price in usability.

Until you turn it on, the new iPod photo (\$499 with a 40-gigabyte drive) looks just like a standard iPod, although it's a tad thicker. The color display is much brighter and easier to read than the regular monochrome screen, but aside from that, its music-player functions are identical to those of its older brother.

What's new is the ability to download pictures—from iPhoto on a Macintosh or Adobe Photoshop Album on Windows—and display them on the 2-sq.-in. screen. Syncing pictures is a bit more complicated to set up than syncing music, but it works smoothly, with the software automatically reducing photo resolution to save space. The iPod gives storage priority to music, so it loads your songs first, then uses the remaining space for pictures. The 40 GB allow plenty of room for both. And it's easy to set up slide shows, the photo equivalent of playlists.

THE PROBLEM IS THE DISPLAY. It's just a bit bigger than a 35mm slide, and the screen provides relatively low resolution, a little more than half the pixel density of the new palmOne Treo 650. So the pictures are tiny and don't look very good. You can hook up the iPod to a television and get a slide show with music if you're willing to fuss a bit. All in all, I'm not sure the photo feature is worth an extra \$100.

The new player 5GB from Virgin Electronics shows the virtues of single-mindedness. At \$250, it's aimed squarely at the popular iPod mini, and while it lacks the mini's cool looks, it adds an extra gigabyte of storage (for a total of five), an FM radio tuner, and a pair of earphone jacks so two people can listen in. The unit is less than 4 in. long and weighs 3.1 oz., compared with the iPod mini's 3.6 in. and 3.6 oz. The controls are logically laid out, with an iPod-like display. Using a high-quality headset, the toughest test of any player, the sound was indistinguishable from the iPod's very good audio. (For more on headsets, see www.businessweek.com/extras.) The Virgin player complies with Microsoft's PlaysForSure standard, so it can handle music purchased or subscribed to from any PlaysForSure source.



VIRGIN ELECTRONICS' PLAYER 5GB

At the other extreme, the \$50 Creative Technology Zen Portable Media Center, based on a Microsoft design, is much more than a music player. It uses its 3.8-in. diagonal display to show videos and display photos. Unfortunately, the Zen doesn't perform so well on several of these tasks. It's fine as a music player, but you gain little advantage from its extra bulk (5.7 in. long and 12 oz.). Despite the relatively huge display, its menus show 10 songs at a time, compared with six on an iPod.

You manage videos and photos for download using Windows Media Player 10 on your PC. But the Media Player is a dreadful tool for organizing photographs. And the Zen's screen, which has even lower resolution than the iPod, doesn't

display them very well. Video works better. You can download TV shows you have recorded—provided you have a Windows Media Center PC. You can also download about 130 specially formatted but obscure movies from CinemaNow. Microsoft hopes to offer more content in early 2005, but at least until then the Zen's appeal as a video player will be limited.

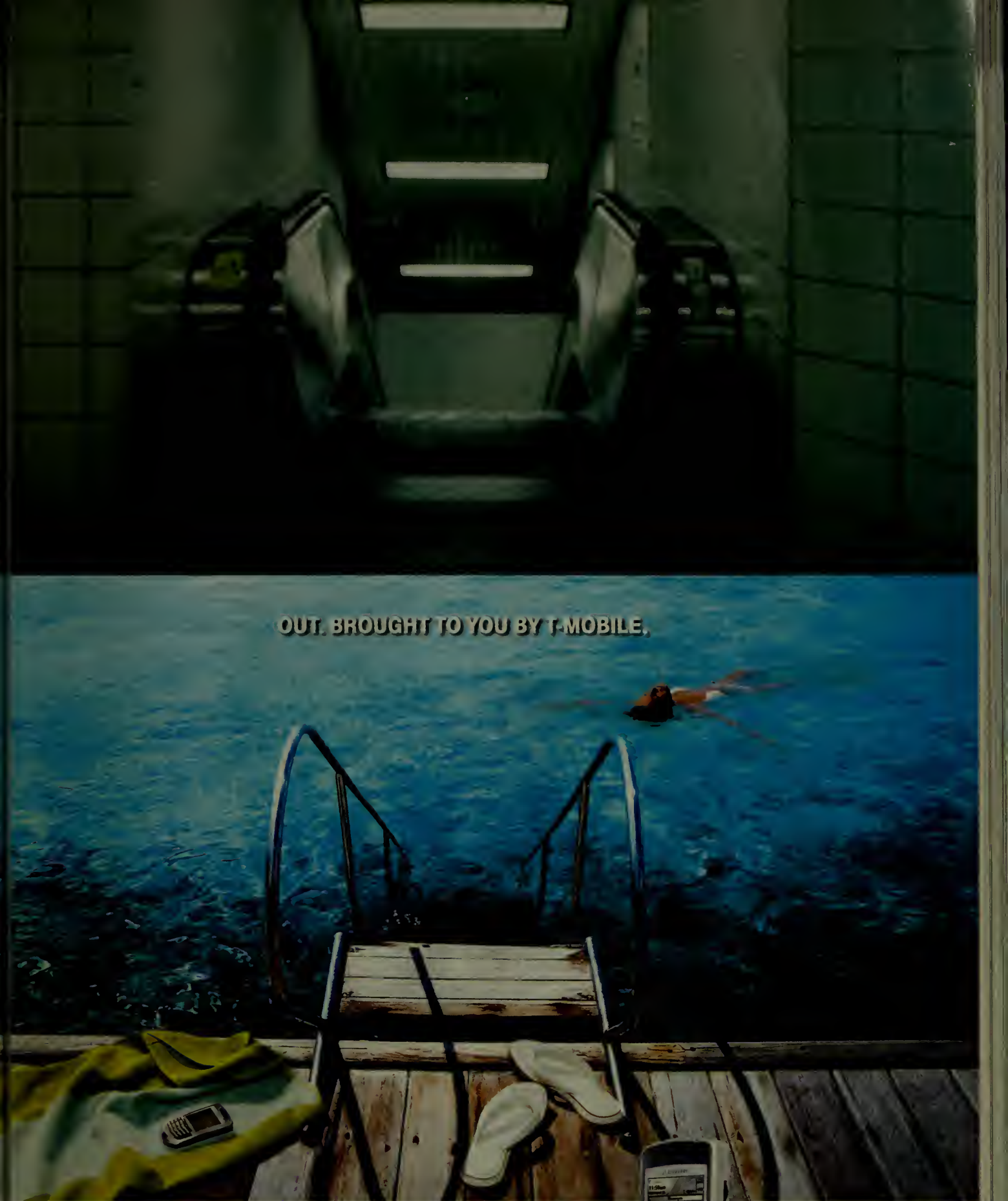
Simplicity remains the key to a good experience on a portable

The new iPod and some of its rivals are trying too hard to show pictures

player—and on this point, Virgin's player gets high marks. If the iPod photo isn't very good at displaying pictures, at least its musical abilities don't suffer for it. The Zen Media Center and Microsoft need to spend some more time pondering the zen of the iPod. ■

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Skirting the Disaster Ahead

COLLAPSE How Societies Choose to Fail or Succeed
By Jared Diamond; Viking; 575pp; \$29.95

Why did great civilizations of the past collapse, and how likely is it that ours will, too? University of California at Los Angeles geography professor and Pulitzer Prize winner Jared Diamond begins his 575-page response to this query by quoting Percy Bysshe Shelley's haunting poem on the faded glories of an Egyptian pharaoh, *Ozymandias*:

... on the [shattered] pedestal these words appear:
'My name is Ozymandias, king of kings:
Look on my works, ye Mighty, and despair!
Nothing beside remains. Round the decay
Of that colossal wreck, boundless and bare
The lone and level sands stretch far away.

It's an apt epigraph for *Collapse: How Societies Choose to Fail or Succeed*, an erudite work that taps the insights of ecology, archaeology, biology, physiology, economic history, and other disciplines. Like his 1997 *Guns, Germs, and Steel: The Fates of Human Societies*, which addressed why European nations ended up wealthy and dominant, the latest book tackles big and vital questions. Here, Diamond suggests that a new Dark Age is a real possibility considering today's global environmental degradation and population growth. Still, he argues that Armageddon isn't inevitable—that societies can “choose” their destinies, as his subtitle puts it. Even so, some readers may find his account overly deterministic and prone to accentuate the negative.

Diamond offers a fascinating excursion into the latest scholarship on some of the great mysteries of history: Easter Island. The Anasazi, an ancient people of the U.S. Southwest. The Maya of Central America. These once-thriving societies disappeared, leaving behind tantalizing monuments of vast achievements that continue to excite our imagination. Diamond also fast-forwards to today. Among the topics he addresses are genocide in Rwanda, the disintegration of Haiti, the environmental squalor of fast-growing China, and the deteriorating ecology of overmined, overlogged Montana.

Diamond also offers a five-point framework describing the dynamics of collapse (and revival). Included are inadvertent environmental damage, climate change, hostile neighbors, the decline of trade with other groups, and the political culture that determines a society's response to a crisis. Throughout, he brings many ancient societies to life, from

those that expired, such as the Norse of Greenland, to those that skirted disaster, like the highland people of New Guinea.

Take the experience of Easter Island, famed for its giant stone statues. Easter is isolated, 2,300 miles from the coast of Chile to the east and 1,300 miles from Polynesia's Pitcairn Island to the west. Archaeologists think the statues' proliferation reflects a rivalry among the island's clans and chiefs. Ever more wood and rope were needed to move the effigies, but a growing population, coupled with the drive for bigger and bigger statues, wiped out the trees. And given the island's extremely fragile ecology, they didn't grow back. A deforested island suffered from soil erosion and a lack of food and raw materials. Starvation, a population crash, cannibalism, and social collapse followed. The author understands why many scholars see “parallels between Easter Island and the whole modern world,” but he hopes the metaphor is imperfect.

Turning to the present, Diamond reports 12 unsustainable ecological trends, from the ruin of natural habitats to atmospheric change. He is most troubled by rapid population growth and the ecological damage caused by the developing world's rush to enjoy First World living standards. One forecast is startling: “the world's environmental problems *will* get resolved, in one way or another, within the lifetimes of the children and the young adults alive today,” he writes. “The only question is whether they will become resolved in pleasant ways of our own choice, or in unpleasant ways not of our choice, such as warfare, genocide, starvation, disease epidemics, and collapses of society.”

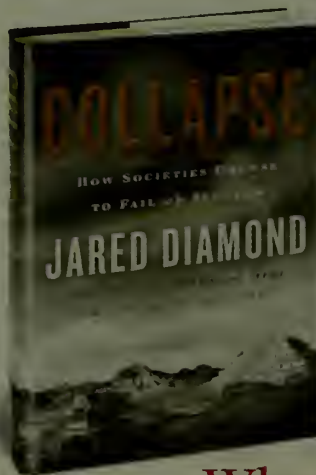
This passage reinforces the sense that Diamond foresees disaster. Yet he calls himself a cautious optimist. Why? Among other things, he shows that some businesses—such as Chevron Corp. in the Kikori River watershed of Papua New Guinea—can be both environmentally conscious and profitable. And he describes some nations such as Japan and Iceland that are restoring environmental balance. But as the book goes on, his hopefulness seems

Why do civilizations fall? Some of today's trends are alarming

to wane. He is far too dismissive of the ability of markets and technological innovation to solve problems. And he mostly dwells on the negatives of growth in the developing world.

That said, *Collapse* is a magisterial effort packed with insight and written with clarity and enthusiasm. It's also the deal of the year—the equivalent of a year's college course by an engaging, brilliant professor, all for the price of a book. ■

—By Christopher Farr



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BY JEFFREY E. GARTEN

A Social Safety Net For the 21st Century

If I were asked to write President George W. Bush's Jan. 20 inauguration address, I would focus on what I believe was his most far-reaching Presidential campaign commitment. "The changed world can be a time of great opportunity for all Americans," he said at the Republican National Convention in August. "And government must take your side. Many of our

most fundamental systems—the tax code, health coverage, pension plans, worker training—were created for the world of yesterday, not tomorrow. We will transform these systems."

I like that simple but profound thought. It reflects American values of individualism and self-reliance. It embodies an optimistic view of what effective government can do, rather than implying, as Bush has often done, that economic growth will solve all problems. It says the welfare state is ending and that something positive must replace it. It acknowledges the need to deal with diminishing job security, including fraying commitments between companies and their employees and retirees, as well as the disruptive impact of millions of workers entering the global market from China, India, and other emerging markets.

THE BIG ISSUE, OF COURSE, is how to design the right policies. And here many of the Administration's ideas fall short. True, some of Bush's prescriptions, often contained in his vision of an "ownership society," in which citizens have more control over their choices ranging from health care to workforce training, have promise. But these ideas must be linked to another concept the President has not promoted nearly enough—a new 21st-century social safety net that gives people time and resources to adjust to change and provides protection against crises beyond their control.

In fact, before proposing a blizzard of new legislation, Bush should articulate the key principles that systemic change must embody. Here's a start: Reforms should not only benefit the rich but have a concrete payoff for the middle and poorer classes. They should be fair to the young and old alike. They should force individuals to take more responsibility for themselves. They shouldn't increase the already exploding fiscal deficit.

For example, the Administration's support for health savings accounts, while potentially valuable, is only a modest innovation in the context of extensive health-care reforms necessary to reduce costs and widen coverage. One example is to have government carry more of the burden for catastrophic coverage. Expanded options for tax-free retirement savings are a good idea. But they should be offered not as a partial privatization of Social Security, with its staggering \$1 trillion

to \$2 trillion of transition costs, but in addition to a reformed Social Security system in which payouts have been brought in line with revenues by raising the retirement age and implementing a more conservative index to calculate benefits.

An overhaul of the tax system could help if it weren't directed only at wealthy investors but also helped Americans retool for new jobs by making some aspects of workers' training and lifetime education tax-deductible. Moreover, existing programs could be expanded, such as offering assistance not just for employees in manufacturing who are hurt by trade, as now happens, but for those in services too.

If the U.S. could better prepare itself for a hypercompetitive global market, that would not only enhance its strength as a

Bush could set off an overhaul as important as the New Deal

society but set an example for Europe and Japan, both struggling with similar issues. By providing an alternative to protectionism, Washington would shore up support for freer trade, too.

President Bush could stimulate social transformation as significant in its implications as the New Deal was in the 1930s. Right now, however, most Americans are woefully uneducated about the benefits, risks, and responsibilities of relying on an increasing array

market-oriented and complicated personal choices. Although many Republican congressional leaders are clamoring for action, the President should engage the country in a more extensive discussion of these challenges before moving ahead.

I don't know how far Bush realistically can get before he becomes a lame duck. But if he succeeds only in building broad bipartisan support for the direction of the change the U.S. requires, he will have secured a very respectable legacy for himself and his party even without a lot of legislative accomplishments. I'm skeptical he'll be that balanced or patient, but I hope I'm wrong. ■

Jeffrey E. Garten is dean of the Yale School of Management (jeffrey.garten@yale.edu).

JAMES C. COOPER & KATHLEEN MADIGAN

Job Growth That Is Just Good Enough

In spite of a weak November, the labor market is giving a boost to the economy

U.S. ECONOMY

If the economy moved in a straight line, a forecaster's job would be simple. But growth comes in both baby steps and giant leaps. That's why the November job gain, while less than expected, is not alarming. The Labor Dept.'s report that only 112,000 jobs were created last month raised fears that the economy has

fallen into another soft patch. The November showing was especially disappointing because the October report, which showed job gains of more than 300,000, seemed to confirm that the U.S. economy had finally shifted into a fast hiring mode.

But the October jump is exactly why November's small gain does not mean the U.S. economy is faltering. Taken together, the two months' data show job growth is averaging at a hefty 207,500 per month so far in the fourth quarter. And so far this year, job growth has averaged 200,000. That pace is in line with an economy growing at an annual rate of 3.5% to 4%. Other data, such as the University indexes from purchasing managers in both manufacturing and service industries, also indicate that the economy is doing well in the fourth quarter and that 2005 will be off to a good start.

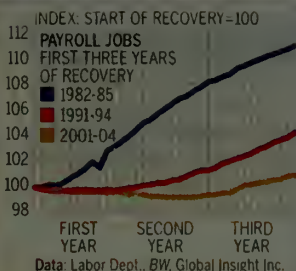
A key problem in interpreting this recovery has been a tendency to focus on the economy through the lens of employment growth. But the upshift in productivity has started a new jobs cycle and changed—maybe forever—how employment enters the economic equation. The problem is that job growth is now slower, but economic growth is strong, unemployment is a low 5.4%, and workers' real wages in this recovery have risen. At the same time, the growth in the labor force has slowed, meaning that even a more subdued pace of job creation may be strong enough to reduce the unemployment rate further in 2005.

MAJOR PROBLEM for consumers right now is not the labor markets. It's costlier energy. Recent reports on holiday shopping show that store sales in the first week in November were up only about 2% from their year-ago beginnings. That tepid showing reflects both higher energy prices and the high level of year-ago retail sales, which were boosted by tax cuts. Gasoline prices, for example, are 30% higher than a year ago. Perhaps fearing that shoppers would not be out in force in November, retailers cut 16,000 jobs from their payrolls last month. The squeeze on budgets is one reason why consumers seem to be waiting for retailers to start discounting again. What may determine the final tally for holiday sales is whether oil prices keep falling—gasoline prices have

already dropped 6% from mid-October to early December—and whether stores resort to heavy discounting in late December. That would tend to lift price-adjusted consumer spending, though at a cost of slimmer profit margins for retailers.

November's hiring gains, while soft, were also widespread across the economy. More than 50% of industries added workers in November, the 11th straight month in which at least half of the industries surveyed did so. One exception, however, was manufacturing. Payrolls there fell 5,000, the third drop in a row. Nevertheless, those losses come at a time when factories are getting busier. The Institute for

THE NEW JOBS CYCLE: A SLOW TAKEOFF



Supply Management said its industrial-activity index rose to 57.8% in November, from 56.8% in October. Both orders and production stood at lofty levels.

What's happening is that almost all of the gain in factory output this year has come from increased productivity, not more jobs. This split is part of an economywide trend that explains why employment won't grow as strongly in 2005 as it did in the 1990s.

INDEED, THE DISAPPOINTING GAIN in November payrolls refocuses attention on the unusually slow pace of job growth in this recovery, which celebrated its third anniversary last month. Even after three years, payrolls have increased by only 0.9% (chart). That's well below the 4.2% gain racked up in the first 36 months of the 1991-94 recovery, which included this country's first brush with a "jobless recovery." The comparison with the 1982-85 post-recession period is even more striking. Back then jobs grew by 10.9%.

Bear in mind that the link between job growth and economic growth is not as strong as it once was. That's because the technology revolution and intense global

competition have led companies to rely more on productivity gains and less on payroll increases to generate most of the gains in output. So far in the current recovery, productivity has grown at a 4.2% annual rate, nearly twice as fast as the 2.4% yearly pace three years into the 1991-94 recovery (chart). But at the same time, real gross domestic product has grown at a 3.5% annual rate in this recovery, slightly faster than the 3.1% pace in the first three years of the 1991-94 upturn.

Moreover, increased productivity has allowed today's companies to grant bigger pay gains, after adjusting for inflation, to their existing employees than businesses did in the two previous recoveries. Even with this year's energy-driven spike in inflation, real hourly pay in November was a shade higher than at the start of the recovery. By contrast, in the first three years of the recoveries in the early '80s and '90s, real hourly pay fell, even while inflation was easing. Looking ahead, with the labor market tightening and oil prices falling back, expect pay raises to outrun inflation at a faster clip in early 2005.

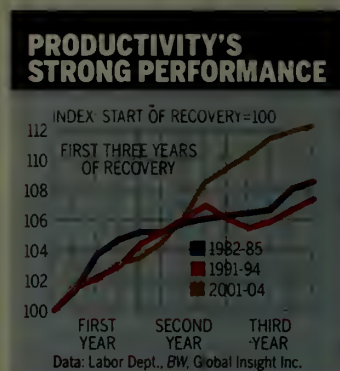
THE LATEST EMPLOYMENT REPORT also dispels the notion that higher productivity is simply throwing a lot of people out of work. Last month's 5.4% jobless rate is exactly the same rate posted in March, 1995, three years into the '90s expansion.

Also, growth in the labor force has slowed to an annual rate of 0.9% over the first three years of recovery. That's partly the result of slower growth in the adult population, and it means that fewer new jobs are needed to keep up

with the influx of job-seekers. So if job growth in 2005 merely matches the 2004 trend of 185,000 per month, hiring will exceed growth in the labor force, and the unemployment rate could sink below 5% by yearend.

The latest labor force data also argue against the notion that the current job market is in bad shape

because today's labor-force participation and unemployment rates don't match the impressive readings of the late 1990s. But it's important to remember that in the late '90s the hyped-up economy and welfare reform drew many people into the labor force who would not normally have sought work. In the five years



ended in 2001, the labor force grew at a 1.6% annual rate well above the 1% trend in the previous five years, which is closer to today's growth rate.

The performance of the labor markets in the late '90s was a historical anomaly. Today's employment patterns are readjusting back to the norm. True, the jobless rate probably won't dip below the 4% rate it hit back then. But heading into 2005, the labor markets are generating enough jobs and incomes to keep consumers spending a healthy clip—and the economy chugging along. ■

ITALY

Will Berlusconi's Tax Cuts Make a Mark?

AFTER MUCH GOVERNMENT

infighting, Prime Minister Silvio Berlusconi finally got an \$8.7 billion tax-cut package passed. Most of the cuts will go to consumers. However, the money could be used more wisely.

On Nov. 26 the government agreed to a bill that cuts income taxes by \$8 billion via adjustments to tax brackets. The hope is that the moves will improve consumer spending, which would boost overall economic growth. In September retail sales were down 1.4% from a year ago, and the November services and manufacturing purchasing managers' indexes fell to their lowest levels since September, 2003.

But economists believe the cuts will

have little impact. "There is a real risk that, given the low level of consumer confidence and anxieties about the future, most of the tax cut will be saved for precautionary motives," says JPMorgan Chase economist Pasquale Diana. Plus, tax hikes on tobacco and other items will offset some of the cuts.

A key source of consumer concern is jobs. The weak labor market can be

traced to the competitive position of Italy's business sector. Both the type of industries and the size of companies that dominate the economy are putting Italy at a competitive disadvantage compared with other countries. Low-tech items such as leather goods, food, and

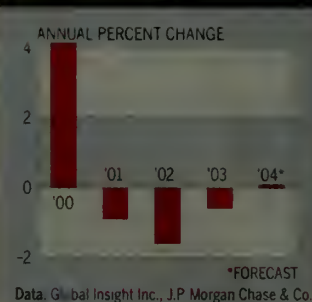
textiles account for a significant part of Italy's exports, but these sectors face growing competition from low-cost producers abroad. The disadvantage is exacerbated by the rising euro.

In addition, the average size of an Italian manufacturer is among the smallest in the euro zone. Smaller businesses typically don't do as much research and development or capital investment as large companies, says Diana. With foreign investment pouring into countries such as China, Italy's smaller businesses risk falling behind even further.

The size of the new tax cuts is fairly small—just 0.5% of gross domestic product. Even so, using the money to help fund R&D programs, boost investment, or help cover Italy's growing public pension obligations would better serve the economy in the long run. ■

—By James Mehring in New York

ITALIAN INDUSTRY IS IN A SLUMP





FOUR WHEELS. FOUR POWER OUTLETS.

PUTTING HYBRID TRUCKS TO WORK WHEN DISASTER STRIKES.

If there were ever any doubts that hybrid vehicles could deliver the same power as their traditional counterparts, they were quickly erased this summer.

As a fleet of hybrid trucks rolled into Florida in the wake of this season's hurricanes, everyone knew they'd help get people and supplies where they needed to go. But in times like these, it seems the real benefit of a hybrid engine is mobile electricity. And with accessory power outlets standard on every GM hybrid, these trucks — capable of running power tools or doubling as generators — actually pack more power than their predecessors.

When power lines are down, it's these outlets — two in the cab and two in the cargo box — that really make an impact. Whether it's running the power tools that help to restore homes, plugging in much-needed medical equipment or just providing some lamplight, electricity plays a critical role in the rebuilding process.

Real world problems. Real world solutions. We're glad our hybrid trucks — the Chevy Silverado and GMC Sierra* — have been able to provide assistance in Florida. But that's just the beginning. In 2006, we plan to introduce a hybrid version of our Saturn VUE. After that, we plan to offer these engines in the GMC Yukon, Chevy Tahoe and Chevy Malibu.

So while they're saving energy, hybrids are also producing it in ways we've never seen before. Which means the question isn't, are they powerful enough? It's more like, how much power do you need?



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ACQUISITIONS

CHINA GOES SHOPPING

Lenovo-IBM is only the highest-profile deal yet in a wave of Western acquisitions that is certain to build

GOT A TIRED BRAND that needs a shot of adrenalin? The answer to your troubles may reside in China. Billions of dollars, euros, and yen have been invested to build up companies on the mainland in the last decade. Now Chinese companies, flush with cash and in command of the world's lowest-cost manufacturing plants, are doing some foreign investing of their own. First it was Huizhou-based TCL Corp. merging its television business with France's Thomson to create the world's biggest TV manufacturer—one of whose brands is venerable RCA. In September, Shanghai Automotive Industry Corp. announced it was buying a 48.9% stake in Korean truckmaker Ssangyong

for close to \$500 million, and there are rumors that SAIC's next target is Britain's troubled MG Rover Group Ltd. Then, on Dec. 7, Beijing-based Lenovo Group Ltd., China's biggest computer maker, agreed to buy a controlling stake in IBM's PC operations for \$1.75 billion (page 35). "We saw a unique opportunity in front of us," says Mary Ma, Lenovo's chief financial officer. "It is an opportunity to differentiate our products and our technology."

GOVERNMENT PUSH

PLENTY OF OTHER Chinese execs will be looking for similar opportunities. China's Commerce Ministry figures the country's corporations spent \$2.85 billion buying foreign companies and other assets in 2003. Straszheim Global Advisors, a Los Angeles-based research outfit that spe-

cializes in Chinese equities, says total outlays by Chinese companies on foreign deals may total as much as \$7 billion in 2004 and could reach \$14 billion in 2006.

Don't expect a bid for Exxon Mobil Corp. or Dell Inc. anytime soon, though—and don't expect the process to be easy. The Chinese have plenty of issues to sort out before they completely master the art of the deal, from smoothing over cultural differences to building up brands to running global supply networks.

But the momentum that's driving China's acquisitive streak is bound to grow. For starters, Beijing wants to create global champions, such as Lenovo in computers or TCL in TVs and mobile phones. "Go glob-

BEIJING Lenovo No. 1 in desktop computers, is buying IBM's PC business

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44 | Steroid scandal? Pass the peanuts



al" has become a catchphrase in China's official media. Beijing has just loosened the reins for companies investing abroad. "This is part of the more developed stage of China's opening to the world," says Gu Kejian, a professor in the Business School at People's University in Beijing.

What's more, though the amounts involved are small now, allowing further overseas investment could eventually help relieve pressure on China's overvalued currency. Investing yuan outside the mainland will balance the inward flow of money lured by a

possible revaluation. And when China lets the yuan appreciate, the buying power of Chinese companies will increase.

Finally, the Chinese need to go abroad for resources to feed their industrial machine and to scare up the talent and research they can't find at home. China National Petroleum Corp., parent of New York Stock Exchange-listed PetroChina; Sinopec, an oil-and-gas company; and CNOOC, an offshore driller, have each invested billions in oil-and-gas projects in Africa, Southeast Asia, and Latin America. More recently talk has been rife that Beijing-based China Minmetals Corp. will spend up to \$5.5 billion to buy Canada's biggest mining company, Noranda Inc.

The next big wave of Chinese overseas investment will come from manufacturers such as Lenovo. China will buy into the industries in which it already competes heavily, particularly electronics, auto parts, appliances, textiles, and apparel. These are industries where acquiring global supply chains can confer big advantages, even for low-cost players like the Chinese. "The Chinese understand that global scale gives them lower-cost components, and that R&D and branding are now done globally," says Paul DiPaola, a managing partner at Bain & Co. China. "Chinese companies in industries



where the economics are global will have no choice but to make these deals."

COMMUNICATION GLITCHES

GLOBAL SCALE HAS motivated Hangzhou-based auto-parts maker Wanxiang Group to buy 10 overseas companies in the last few years, including NASDAQ-listed Universal Automotive Industries Inc. "We combine international and domestic resources to speed up development," says Chairman Lu Guanqiu. The Chinese certainly have to do something. Their cell-phone, washing-machine, and electronics makers face overcapacity and razor-thin margins in their home market, where they already often compete with the world's best brands. Lenovo, for example, is No. 1 in desktop computers in China, but it has been under pressure from Dell and other non-Chinese brands. And as they enter foreign markets, Chinese execs realize they lack essential skills. "China needs brand names, reach, logos, marketing, distribution—and the management that attends to all of those," says Donald Straszheim, head of Straszheim Global Advisors.

The pressing question is whether the Chinese can get what they're looking for. Asians have a long history of overpaying for foreign assets: Remember the Japanese,

with their ill-fated U.S. real estate and entertainment-industry deals? Analysts say China's oil companies have already spent too much on overseas reserves.

The Chinese have internal problems well. Too many of their best-known companies, such as appliance maker Haier Group Co., rely on the vision of a charismatic founder and have little management depth. A merger can struggle with cultural differences, including management styles and big pay gaps between Chinese and Western executives.

Thomson and TCL, for example, have a lot to thrash out. In China, says one TCL official, "if the leader says something right, even if he is wrong, employees will agree with him. But in foreign companies they will not agree with him. We have two different cultures." Alar E. Arras, president of TCL-Thomson Electronics, says the venture is working through pay issues and other problems, but he concedes the hurdles: Try solving a technical glitch through translators, for example. "The communication challenge is one of the unique items we face," he says.

Given the problems, the Chinese must try various tactics in their forays abroad. Edward King, executive director of mergers and acquisitions at Morgan Stanley in Hong Kong, figures they will use joint ventures more than outright acquisitions spread responsibility for making a deal work. But one way or another, more of those deals are on the way. ■

—By Dexter Roberts in Beijing, with Frederic Balfour in Hong Kong, Pete Engardio in New York, and Joseph Weber in Chicago

China Abroad

Big Chinese companies have recently made or are considering lots of foreign acquisitions. Some deals:

TCL-THOMSON The Huizhou electronics company merged its TV unit with that of France's Thomson, acquiring the RCA brand in the U.S. Revenues this year: \$4 billion.

SHANGHAI AUTOMOTIVE-SSANGYONG The Chinese auto maker paid \$500 million for almost 50% of the Korean truckmaker. It may also buy control of Britain's Rover.

WANXIANG-UNIVERSAL AUTOMOTIVE The auto-parts company has bought 10 U.S. companies, including a stake in Nasdaq-listed Universal Automotive Industries.

UTSTARCOM-AUDIOVOX The U.S. gearmaker, which has most of its sales and workers in China, bought the cell-phone business of Long Island-based Audiovox for \$165 million.

CHINA MINMETALS-NORANDA China's mining giant is considering offering as much as \$5.5 billion for the Canadian nickel-and-copper miner.

BusinessWeek online

For a Q&A with Lenovo Chief Financial Officer Mary Ma, visit www.businessweek.com/magazine/extra.htm

Data Company reports

INFORMATION TECHNOLOGY

BIG BLUE'S BOLD STEP INTO CHINA

Teaming with Lenovo spells opportunity
—if it can meet the big challenges ahead

IT DOESN'T TAKE A GENIUS TO see why IBM's sale of its \$10 billion-a-year PC business to China's Lenovo Group Ltd. relieves a huge headache for Big Blue. The computer giant gets the barely profitable business off its books so it can expand profit margins and invest in more promising technologies. But there's an even bigger prize IBM executives have their eyes on. By lining up Lenovo as a strategic partner, IBM has a chance to rapidly enlarge its footprint in China, which could one day rival Europe as the world's second-biggest information technology market, behind the U.S.

The deal with Lenovo isn't your garden-variety sale. On Dec. 7, IBM unveiled plans to sell most of its Personal Systems Group to Lenovo for \$1.75 billion in cash, stock, and assumed liabilities. Lenovo will relocate its world headquarters from Beijing to Armonk, N.Y., near IBM's home base, and the business will be run by veteran

WARD Lenovo's new chief will be making frequent trips to Beijing

IBM execs. Lenovo's new CEO will be Stephen M. Ward Jr., who now runs IBM's Personal Systems Group. IBM will take an 8.9% ownership stake in the new company, which will sell PCs under the IBM brand. "The rest of the PC industry is now competing with a Chinese company, with its aggressiveness on price, backed with the quality and services of IBM," says CEO Samuel J. Palmisano.

The transaction makes sense for both sides. IBM gets to keep selling PCs, which helps it market other products and services to corporations in packages. At the same time the deal removes an earnings drag. Lenovo, China's No. 1 PC maker, buys itself a global PC operation and instant entry into computing's big leagues. Combined, the companies have an 8.6%



Plenty of Risk

CULTURE CLASH The new Lenovo will be a Chinese company run by Americans. Management will have to bridge 6,800 miles and huge cultural differences.

MARKET CONFUSION Lenovo PCs will carry the IBM brand name, and many will be sold by IBM's salesforce. But some corporate customers may no longer trust the IBM PC brand.

FIERCE COMPETITION Even assuming a smooth and well-run merger of Lenovo and IBM's PC business, Dell will still be more efficient thanks to its direct-sales model.

PC market share, No. 3 behind Dell Inc. and Hewlett-Packard Co. "Lenovo gets what it wants—a worldwide presence. And IBM gets what it wants," says analyst Phillipe de Marcillac at technology mar-

ket researcher IDC. IBM, he points out, will still have a product offering for its large accounts without having to manufacture commodity machines.

THE DELL FACTOR

OF COURSE, THERE'S STILL plenty that could go wrong. Lenovo's new leaders will have to bridge not only the 6,800 miles from New York to Beijing but also immense cultural differences. Lenovo PCs will carry the IBM name for five years, and former IBMers will be among the product designers, but some corporate customers may not trust Lenovo to deliver the quality and innovation they have counted on from IBM. And tech combos

far less complex than this one have been notoriously difficult to pull off in the past. Notes Dell Chairman Michael S. Dell: "When was the last time you saw a successful acquisition or merger in the computer industry?"

Of course, Dell is hardly an impartial observer—he will remain the combined company's toughest rival. Indeed, while merging Lenovo and IBM's PC businesses will provide economies of scale, Dell, the No. 1 PC maker, still has a more efficient operation thanks to its direct-sales model. Even in China, Lenovo and IBM face a fierce competitor in Dell. It's already doing well in selling PCs to corporate customers, and Dell has also started to pick up some government business, a Lenovo stronghold.

The deal might turn out to be better for IBM than Lenovo. In the U.S. and Europe, Lenovo will "start off great, but gradually they'll lose share," predicts analyst Stephen Baker of NPD Group. "HP and Dell will be after the IBM accounts with all guns blazing." But IBM will have a chance to mine the Lenovo connection in China, the world's seventh-largest economy. IBM aims to sell more high-margin servers, software, and services

to a market that has been snapping up PCs fast for half a decade but is just now developing a taste for more sophisticated stuff. The Chinese tech market is expected to double, from \$24 billion last year to

\$479 billion in 2008, according to IDC. During the same period Chinese demand for services is expected to leap from \$3.7 billion to \$11.6 billion.

BRIDGING THE CULTURE GAP

IBM SEES LENOVO as a good catch because it's the dominant player in Chinese computing. It has a 27% market share in PCs and remains strong in government and education markets. That's thanks in part to the Chinese government, which held a 57% stake in the company before the IBM deal and will now hold a 46% stake. IBM hopes to piggyback on Lenovo's influence and sales force as it targets Chinese banks, manufacturing companies, government agencies, and consumer-product outfits with its servers and services. Lenovo has been holding its own in PC market share while Dell and IBM have been gaining at the expense of other players. Lenovo and IBM hope they will be able to slow Dell and hold onto their combined 32% share. "We see a synergy of Lenovo leading with PCs and identifying opportunities for IBM, and IBM leading with solutions that will require PCs from Lenovo," says Ward.

Figuring out how to stay on top in China will be one of Ward's top priorities. IBM PC sales through the company's salesforce and thousands of resellers worldwide are running smoothly. That should free Ward up for frequent trips to China so he can learn firsthand about the market there and his new Lenovo colleagues in Beijing.

Bridging the culture gap will be key. Lenovo will be run day-to-day by Ward and, as chief operating officer, Frances O'Sullivan, who is now general manager of IBM's PC unit. The nonexecutive chairman will be Yang Yuanqing, now Lenovo's CEO, who will also work in New York. Clarence Kwan, managing partner at consultant Deloitte & Touche, thinks it will help that the PC business is by its nature global in terms of sourcing components, manufacturing, and product development—so both sides already play by the same rules.

Even so, the culture clash and management challenges will be daunting. Can Lenovo and IBM pull it off? An icon of Western capitalism is teaming up with a company that's partly owned by the Chinese government to tap into the fast-evolving global marketplace. How the world has changed. ■

—By Steve Hamm, with
Pete Engardio in New York and
Frederik Balfour in Hong Kong

THE INTERNET

E-TAILING FINALLY HITS ITS STRIDE

As it gains popularity, online shopping transforms how all merchants operate

BILL BASS AND JON K. Stein are two very different kinds of Internet merchant. Bass runs Sears.com, the online arm of the retail giant, where sales are up more than 40% this year. Stein owns Jake's Dog House in Cherry Hill, N.J., a chain of five pet-supply stores that gets about \$250,000 of yearly sales over the Web—and expects them to double in 2005. As different as they are, the Internet is at the heart of both their expansion plans.

As e-tailing heads into its 10th holiday season, it is coming of age. With more households shifting to faster broadband connections and online shopping increasingly friendly, Americans are purchasing ever more stuff on the Web. Analysts at Forrester Research Inc. say U.S. online sales will reach \$145 billion this year—or 7% of U.S. retail sales. While growth has slowed from last year's hefty 38% gain, that's still a 26% leap from the \$114 billion racked up in 2003.

But the numbers tell only part of the story. Big changes are percolating through e-tailing—and spilling over into the broader world of retailing. For one, giants such as Sears, Roebuck & Co. and Wal-Mart Stores Inc. have finally gotten

serious about the Net. They are chasing new markets online and using their size to force down prices, just as they have done in the brick-and-mortar world.

NICHES UNLIMITED

AT THE SAME TIME, thousands of niche players like Stein are reaching a national audience through the Web. "I've got customers in all 50 states," he says. And while some outfits aren't much bigger than mom-and-pops, being a niche player doesn't have to mean staying small. A growing number, including e-jeweler Blue Nile, luggage site eBags, and shoe retailer Zappos.com, are racking up sales of \$100 million a year or more. "There's an unlimited number of niche markets out there," says John Seely Brown, a director at Amazon and visiting scholar at the University of Southern California's Annenberg Center for Communication. "It's the new economic model."

Indeed, in the past couple of years, the increasing sophistication of search technology and comparison-shopping sites have allowed online businesses cheaply and effectively to market their products to millions of potential customers. Often these innovations are bringing less-well-known brands and merchants to consumers' attention. People simply type

The E-tail Effect

How e-commerce is shaking up the retail landscape:

THE BIG GUNS ARRIVE

After early struggles, online sales at brick-and-mortar giants such as Wal-Mart, Sears, and Gap are soaring. These chains are also using the Web to test new products and move into new markets.

NICHES GO NATIONAL

More and more niche players are succeeding by offering variety rivals can't match. Luggage seller eBags, for example, is able to stock 12,000 styles, compared with 250 in a typical store.

SEARCH LENDS A HAND

Using Google and similar Web search engines, consumers can search far and for specialized products—say, stainless-steel sinks. That's creating new markets for lesser-known brands and new merchants.



results—has made it more cost-effective for online entrepreneurs to set up shop on their own. In the early days of the late 1990s, pioneer online merchants fruitlessly spent millions of dollars on TV and radio ads aimed at the mass market. Search-linked advertising has changed all of that. Nowadays, online companies pay Google or Yahoo! only when a customer clicks on their search ad. Blue Nile, for example, can get a prospect for a \$5,000 diamond ring by paying Yahoo \$1.12 per click. Search-based, targeted advertising helped make e-tailing a much less capital-intensive, risky business. Perfect for the small guy.

The Web's favorable economics don't stop there. Online merchants can offer a far broader array of merchandise than specialty brick-and-mortar retailers, since they don't have to keep the products on store shelves. Consider eBags Inc., the suburban Denver luggage purveyor. It easily dwarfs the selection a local specialty store can keep in stock. "We carry 12,000 bags; they have 250, most of them black," laughs Peter Cobb, eBags' vice-president for marketing.

It's too early to say how all of this will play out, but it may well produce a bifurcation of American retailing. At one end will be huge commodity sellers able to compete in an online world dominated by price comparison sites and consumers who do careful research

and shop on price. Look for search engines and sites such as Shopping.com and Shopzilla to do to markets such as cameras and plasma TVs what Dell Inc. did to computers: Make it impossible for any but the most efficient retailers, online or off, to survive. At the other end, smaller players from gift site RedEnvelope Inc. to Stein's pet stores will fight to differentiate themselves. When Alison L. May became RedEnvelope's CEO in 2002, she refocused the strategy on selling goods designed in-house. "The way you protect brands is the same as at the mall," she says. "You sell things people can't get everywhere else."

The Internet promised an era of more choice, better prices, and greater customer satisfaction. And as the Web reaches adolescence, that's what's arrived. ■

—By Timothy J. Mullaney in New York
and Robert D. Hof in San Mateo, Calif.,
with bureau reports

that they're looking for into a search site, and they're instantly spoiled for choice. The forces being unleashed have not been met on that icon of e-tailing, Amazon's Jeff Bezos. He recently told a New York audience: "We're going to see more richly varied products for people."

It also means a more richly varied network of suppliers. For several years, e-tailing was dominated by a handful of online merchants—the likes of Amazon, eBay, and Lands' End. And while they continue to post strong growth rates, they are facing increasing competition. Much of it comes from a host of Establishment retailers that were late to the party and becoming increasingly Web savvy. Says Sears.com's Bass: "A number of really large companies are just getting started."

The big chains are harnessing the Web not just to sell more stuff but also to test

new products. Gap Inc.'s Old Navy unit is testing plus-size women's underwear online, for example. Wal-Mart, meanwhile, is using its site to try out fancy merchandise its stores don't stock—including such upscale products as baseball memorabilia, cashmere sweaters, and \$6,000 plasma TVs. Says Wal-Mart.com President John Fleming: "We play in specialty markets where you wouldn't think of Wal-Mart playing."

FINGER PUPPETS

EVEN AS THE BIG GUYS muscle in, small fry are also proliferating. For several years, many smaller players have launched online stores under the aegis of eBay. According to the online giant, 430,000 people in the U.S. make all or part of their living as eBay merchants—up from 150,000 in 2002. EBay's merchants now hawk everything from SpongeBob SquarePants finger puppets to classic Ford Mustangs.

The advent of search-related advertising—the ads that appear next to search

SPECIAL GIFTS
Red Envelope focuses on items not sold in shops

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OIL

FOR A CHANGE, OPEC IS WORRIED

Supply is ahead of demand—but falling prices probably won't last long

CAN OIL CONSUMERS breathe a sigh of relief? After a 25% drop in the price of benchmark West Texas Intermediate crude since late October, there's reason to think so. Even an attack on the U.S. consulate in Saudi Arabia on Dec. 6 did little to rattle investors. But with OPEC pondering production cuts and the peak winter heating season still ahead, the pullback, to about \$42, might be short-lived. Even those forecasting lower oil prices later next year point to wild cards: unexpected growth in demand or the sorts of supply disruptions that have jolted the market all year.

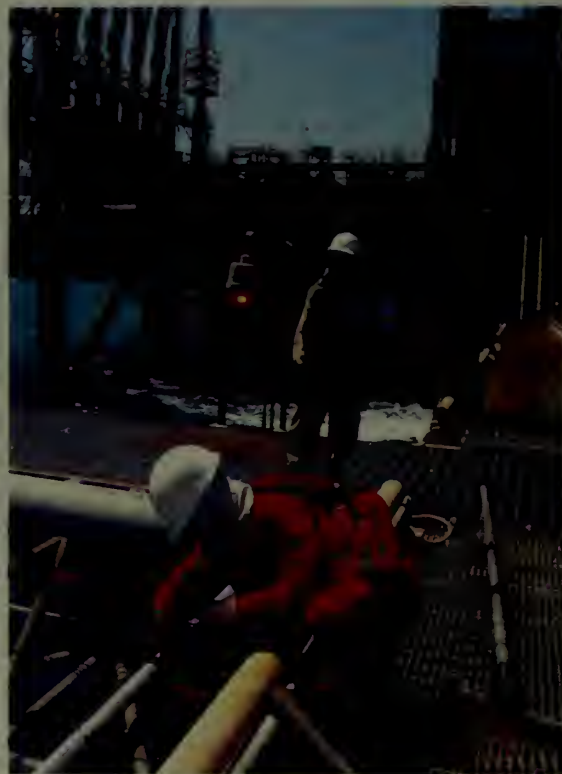
For now, oil traders and speculators are shifting their positions following reports of better-than-expected inventories. With OPEC producing more oil than it has in 25 years, "what we're seeing is supply in excess of demand

SAUDI ARABIA

Cartel members are considering production cuts

at a time when we don't typically see that," notes James Burkhard, director of global oil-market research at consultant Cambridge Energy Research Associates Inc. Excluding Iraq, he figures OPEC's production is up more than 2 million barrels per day since April. And for all the fear of supply shortages from war, terrorism, and political upheaval in places like Russia and Venezuela, such outages haven't happened.

The herd mentality among oil speculators leaving the market has exacerbated the price drop, says independent energy trader Eric Bolling. Barring a harsh winter, he predicts a further retreat to \$33 to \$35 per barrel. Hedge funds, banks, and other speculators "have been really exaggerating the potential for supply disruptions from day one," says



analyst Fadel Gheit of Oppenheimer & Co. "Remember, volatility is their best ally. If the market is stable, they go out of business."

The swift drop has OPEC worried for a change. The cartel is looking toward the second quarter, when demand always falls. OPEC members are considering production cuts to support prices and trying to scare the speculators. While \$42 oil is still up about 30% from a year ago, OPEC sells much of its lower-quality oil for far less than the benchmark West Texas price. And its members have

also been squeezed by the dollar's slide

Energy prices are keeping consumer and companies on edge—and few are counting on relief anytime soon. Chrysler Group chief economist Van Jolissain says the possibility of continued high oil prices remains the biggest threat to auto sales. America West Airlines is planning its 2005 budget based on \$45 a barrel. "We can't run the business assuming things are going to be better than they are," says CEO W. Douglas Parker. And the country's huge budget and trade deficits are bigger economic problems than the price of oil, says analyst Gheit. "Lower oil prices will help [the economy] but not by as much as many people think," he says.

Oil producers are mindful that this year's increase in demand, the biggest since 1978, could slow in 2005, even as production capacity grows. CERA projects that with slower global economic growth next year, including a cooling economy in China, spare oil production capacity could climb from 1 million to 1.2 million barrels a day to a more normal 3 million barrels by the middle of next year.

WILD CARDS

WITH A NORMAL winter, oil prices could fall to the mid-\$30 range by midyear. Unless OPEC acts in a "very unified way" to restrain production, oil prices could even hit \$25 a barrel or lower, predicts analyst Frederick P. Leffler of Bear, Stearns & Co.

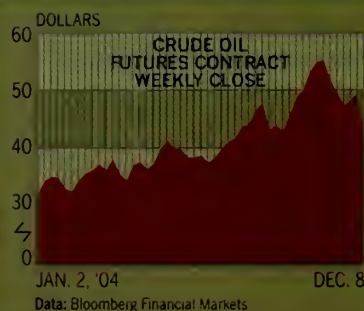
But as this year's skyrocketing energy prices have shown, a lot could happen to derail the forecast. Demand could surge

anew. Disruptions in Russia, Iraq, Nigeria and elsewhere could yet curtail supplies while refinery capacity, oil tankers, and other infrastructure are stretched thin. "If there's a fear factor, it's there for a good reason," insists Matthew R. Simmons, CEO of Houston investment bank Simmons

& Co. International. For the time being, though, fear seems to have loosened its grip on the market. ■

—By Wendy Zellner in Dallas, with Christopher Palmeri in Los Angeles, Laurie Cohn in London, and bureau reports

STILL PRICEY



COMMENTARY

BY AMY BARRETT

J&J: Don't Stop Dealmaking Now

Patent expirations and a thin pipeline mean the giant needs more than Guidant

IT HAS BEEN A LONG and tortured courtship. For years, health-care giant Johnson & Johnson has held on—again, off-again acquisition talks with medical-device maker Guidant Corp. Now Wall Street sources say the companies are talking again. While a deal is far from assured, it appears J&J and Guidant are closer than they've ever been linking up.

Even if J&J pulls off the Guidant deal, don't expect the company to put its checkbook away for long. Certainly, Guidant could be a good acquisition for the \$47 billion J&J, giving it a piece of the fast-growing market for implantable defibrillators, which correct overly rapid heartbeats and help stave off cardiac arrest. And the deal—which analysts figure would be valued at about \$25 billion—could give a boost to slowing revenue growth over the next few years. But New Brunswick (N.J.)-based J&J could face a slowdown again later in the decade. The culprit: its large pharmaceutical business, which, like the rest of the drug industry, is facing patent expirations, intensifying competition, and a dearth of new products.

That's why Johnson & Johnson needs to continue hunting for deals—and why Chairman and Chief Executive William C. Welton wants to bulk up in the medical-device business, which has been on a tear of late. J&J already garners 36% of its sales from medical devices and diagnostic testing business, a sector that enjoys healthy margins and the potential for lucrative new products in years ahead. And few companies are stronger than Guidant, a major force in the fast-growing market for implantable defibrillators, which rack up sales of \$4.7 billion a year. Credit Suisse First Boston analyst Adam K. Galeon figures that without jumping into that market, J&J earnings, excluding onetime items, would rise just 10% in 2005 and 2006, down from the mid-teens rate of the last few years.

What's more, the deal could improve J&J's prospects in the lucrative market for drug-coated stents, which help prevent arteries from relogging after angioplasty. While Guidant does not have a drug-coated stent approved in the U.S. yet, it sells a drug-coated stent that experts say is

**Nowadays,
devices are
promising
faster
growth than
drugs**



J&J'S WELDON
One possible
result of the
combo: A
better stent

more flexible and easier to use than J&J's drug-coated Cypher stent. If regulators let J&J hold on to Guidant's stent operation, combining J&J expertise in drug coating with Guidant's popular stent could help J&J catch up to market leader Boston Scientific Corp. And a deal could also help J&J add some strong managers from the Guidant ranks—a plus, considering some of the stumbles with the rollout of its Cypher product last year.

That all assumes, however, that the companies can reach a deal—and that they aren't tripped up on antitrust issues. Only J&J and Boston Scientific make drug-coated stents. Guidant is developing its own drug-coated stent, and U.S. regulators may require some divestiture.

Other potential problems could surface as well. Guidant's entrepreneurial approach could clash with J&J's buttoned-down management style. "The question is whether J&J can maintain [Guidant's] aggressive, youthful culture," warns Sanford C. Bernstein & Co. analyst Bruce M. Nudell.

If J&J can overcome those hurdles, access to Guidant technology could set the stage for promising new products. Guidant is in the early stages of studying ways to deliver drugs to plaques that have built up in the heart. It is also doing early research on how to adapt pacemaker-type devices to combat other diseases or disorders. For instance, they may be able to use electrical impulses to halt epileptic seizures. Linking up with J&J would give Guidant considerable financial resources to fund such projects as well as major marketing power to launch new products. No doubt Johnson & Johnson execs will use those selling points as they pursue Guidant—and other potential partners—in the days and months ahead. ■

—With Michael Arndt in Chicago

HOTELS

HYATT: QUITE A HOUSECLEANING

Are the Pritzkers getting set to take their sprawling empire public?

WITH HIS FAMILY racked by dissension for the past five years, Hyatt hotels Chief Thomas J. Pritzker hasn't always found it easy to focus on running his Chicago-based hotel empire. While rivals such as Hilton Hotels Corp. and Marriott International Inc. have rushed into fast-growing markets, such as modestly priced suites hotels, Pritzker stayed on the sidelines. Instead, he insisted on sticking with the slower-growth upscale and luxury-resort market. Much of his energy also went into trying to placate a dozen restless relatives, some of whom are unhappy with Pritzker's management of the \$15 billion family empire.

Now, however, the 54-year-old dealmaker—the fourth-generation Pritzker to oversee the privately held business—may be regaining his stride. For starters, he's taking the tony \$6-billion-a-year Hyatt chain in a new direction. On Dec. 9, he was expected to announce an acquisition of the \$300 million-a-year, 143-hotel AmeriSuites chain. Just as important, he's reorganizing the company and renaming it Global Hyatt. The move could ease the way toward taking Hyatt public—probably the key to resolving the family feud.

NOT QUITE SO SPIFFY

THE DEAL FOR AmeriSuites, which industry insiders believe will cost Hyatt some \$600 million to \$700 million, will move the full-service, 214-hotel chain into the so-called limited-service arena, where hotels are generally cheaper and lack such amenities as fancy restaurants.

AmeriSuites will soon sport the Hyatt name, much as Courtyard by Marriott uses its parent company's name. As part of the deal, Hyatt will also pick up management contracts for a dozen more hotels—operating under the Prime Hotels name—which have about \$55 million in sales every year.

Certainly, it's a move in the right direction. AmeriSuites' real estate alone was valued in 2002 at \$556 million by a CIBC analyst. Although some of its hotel properties are in need of upgrading, for the most part they are relatively young hostleries. Nevertheless, Hyatt, which is buying AmeriSuites from the Blackstone Group, is coming late to the all-suites market, a vein that has already been well mined by competitors.

Pritzker's ambitions may take more than \$1 billion in capital

The bigger news may well be that Pritzker says Hyatt's reorganization “is consistent with” going public. Although no decisions have been made, he and his fractious relatives appear to be moving toward that eventual option. For two years, Pritzker has worked to shift non-hotel businesses out from under the Hyatt management umbrella. Now he's uniting his once-separate international and domestic Hyatt management teams in a gleaming new 49-story tower, the Hyatt Center, developed in Chicago's financial district by Pritzker's cousin, Penny S. Pritzker.

Clearly, the changes are designed to please Wall Street. “What we have ended up with is a platform from which we can drive growth and shareholder value,” says Pritzker. Execs say consolidated financial reporting will make the activities of Global Hyatt more understandable to



the financial community. That will give the company access to “cost-effective financing” for current business and future deals they say.

CEO TOM PRITZKER
He's branching out—into a less tony slice of the market

Just how a publicly traded Hyatt would fare, though, is difficult to say. It would be only the 10th-largest hotel chain in terms of the number of rooms owned. Although the brand would be a big asset, the company would be under intense pressure to grow. Pritzker may invest over \$1 billion in Global Hyatt to realize his lofty ambitions. Already, Hyatt has 27 new hotels under development in 15 countries ranging from Vietnam to Dubai. Pritzker has recently been busy with new hotel projects in nine Chinese locales, ranging from Beijing and Macau to Nanjing and Shanghai. He wants to make Hyatt one of the biggest hotel chains in China.

Nor is Pritzker out of the woods with his family yet. His cousins, Liesel and Matthew, are pressing ahead with a lawsuit against the Hyatt chief and other Pritzkers—including their own father, Robert A. Pritzker—for a bigger share of the family fortune. And resentments still linger among some relatives, stemming from late patriarch Jay Pritzker's decision to give Thomas, his son, leadership of the family fortune. While the Hyatt chief may yet make his quarrelsome family happier, that's likely only if his new moves fattens their inheritance even more. ■

—By Joseph Weber in Chicago

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CHARITIES

THE SALVATION ARMY'S LEAKY KETTLE

Just when the agency needs more cash, retailers are foiling its fund-raising strategy

THESE ARE TOUGH TIMES for the Salvation Army's bell-ringers. On Nov. 25, giant discounter Target Corp. began enforcing a longstanding ban that prevents charities from collecting donations outside its stores. Making an exception for the Salvation Army might force the chain to welcome other charities that don't sit well with customers. The move was a big blow to the nation's largest charity: Last year kettle-ringers outside Target stores collected \$9 million, about 10% of the Salvation Army's holiday take.

Target isn't the only one. Rival Wal-Mart now limits the kettle drive outside its stores to just 14 days each year. Indeed, with a growing number of stores banning or limiting the Salvation Army and its once ubiquitous kettles, the charity finds itself in a serious fix. Even as the money it needs to fund its traditional homeless shelters and soup kitchens is drying up, it also must come up with a huge new pot of cash to operate plush

community centers that will be built with a \$1.5 billion bequest from McDonald's Corp. heiress Joan Kroc. The upshot: The Salvation Army will have to modernize its fund-raising efforts. Says Dwight F. Burlingame, a fund-raising expert at the Center of Philanthropy at Indiana University: "They need to professionalize what has been a volunteer effort."

BAKE SALES

THE SALVATION Army acknowledges that will be quite a challenge. After all, the organization has been raising funds pretty much the same way for its entire 139-year history. The group relies on grassroots efforts organized by local community centers—bake sales, radio requests, and the like, along with donations from local businesses and community members. And once a year, bell-ringers man their

BRIEF SEASON
Wal-Mart limits the Army's drive to 14 days a year

stations in pursuit of holiday shopper pocket change. As told, those efforts brought in \$1.4

billion last year.

It all sounds like quite a kettleful. But those resources, which fund the Salvation Army's 9,027 local centers, are already stretched thin. And now the agency must come up with roughly \$70 million more to match the money Kroc put up to run the 30 to 50 new Kroc Centers. She stipulated that her gift cover half the expense and challenged the Army to foot the rest. That might not seem like much, but the charity's decentralized fund-raising means money isn't shared among regions. Money raised locally is spent locally. So the communities where Kroc Centers will be built have to come up with the cash on their own.

With Mrs. Kroc's money expected to start arriving early next year, there's little time to lose. Fund-raising experts say the Army's national headquarters must take a stronger role. Apart from the kettle drive, no programs to raise cash are run nationally. The Army headquarters could also use more professionals trained in the art of raising money.

New programs, such as a cohesive online-giving drive or efforts geared to garnering support from corporate donors and individuals like the Krocs, would go a long way toward filling the gap. In fact,

working with companies is crucial: Target says it asked the Salvation Army to come up with a new fund-raising strategy but the charity has so far failed to offer an alternative.

Salvation Army stalwarts are almost certain to resist change, since hiring high-paid professionals could undermine a culture largely defined by an implicit vow of poverty. But other institutions have made such a shift. The Catholic Church, for one, brought in fund-raisers.

The Kroc gift—however magnanimous—could force the charity to choose between big-budget Kroc centers with swimming pools and some of the traditional programs that last year served 33 million people. Only by bringing its fund-raising techniques into the 21st century can the Salvation Army afford to do both. ■

—By Jessi Hempel in New York

THE STAT

\$9
MILLION

Money raised by Salvation Army outside Target stores last year—10% of total kettle donations

Data: Salvation Army

Three of the "25 best funds"*

—Kiplinger's, May 2004

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Growth Stock Fund Invests in well-established companies believed to be poised for long-term growth, mainly in the U.S.	10.96%	1.62%	10.91%

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COMMENTARY

BY MARK HYMAN

Steroid Scandal? Pass the Peanuts

Do fans care half as much as a few politicians and media scolds?

IF THERE WAS ANYTHING more predictable than the disclosure this month that baseball sluggers Jason Giambi and Barry Bonds used steroids to pump up their muscles and pad their home-run stats, it was what happened next. Those in position to gain from the scandal pounced. Sports talk-radio jocks hammered at the stars for betraying the public trust. The

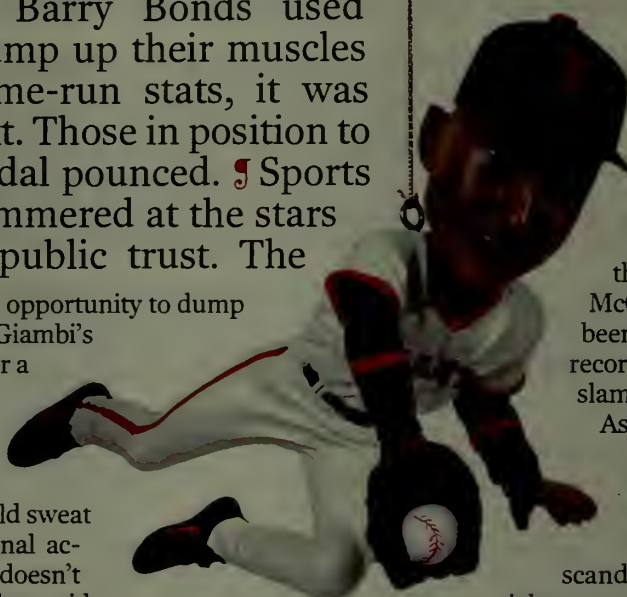
New York Yankees, spying an opportunity to dump the remaining \$82 million of Giambi's bloated contract, scrambled for a loophole. Senator John McCain (R-Ariz.), whose grandstanding about cleaning up pro boxing so far has amounted to a hill of old sweat socks, threatened congressional action if Major League Baseball doesn't put the arm on meaty-armed steroid abusers. And President Bush urged baseball to take "strong steps."

But baseball fans? They seem a lot more interested in the free-agent mating dance between Red Sox hurler Pedro Martinez and Yankees principal owner George ("Who's Your Sugar Daddy?") Steinbrenner.

What Giambi did—at least in allegations that have come out so far in the Balco steroids case—was wrong. Wrong and dumb. His admission to a grand jury in December, 2003, that he injected himself with human growth hormone and had been using steroids at least two years earlier brands him as a cheat. Bonds hasn't exactly burnished his image, either. He claims never to have knowingly used steroids. But if you accept the San Francisco Giants star's cockeyed story about using creams he thought were harmless arthritis remedies, then there's a long golden bridge you might want to buy.

Sure, rank-and-file baseball fans are dismayed by the seamy revelations of steroid use, which follow years of forceful denials from the players about who took what. But do fans care even half as much about steroidgate as a few self-interested politi-

NAUGHTY OR NICE? MLB's Web site sells a Bonds tree ornament



Rumors of steroid use didn't dent MLB gate receipts last year

cians and media scolds? No question, the baseball public supports a drug-free game. In an ESPN.com poll, 93% said that using steroids is wrong and taints the sport. About 45% said an appropriate punishment for a player testing positive for steroid use would be a year's suspension. That's hardly a call for amnesty.

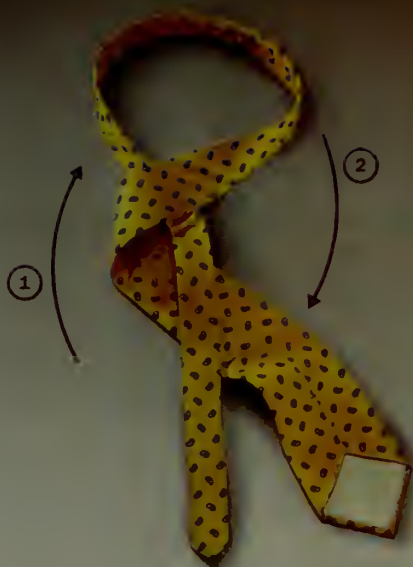
But if baseball fans frown on steroid users, they also seem inexorably drawn to bulging biceps and smashing home runs. Tick off some of the highlight-reel moments in baseball over the past five seasons: the home-run duel in 1998 between Marlon Byrd and Sammy Sosa (neither of whom has been implicated in the steroid scandal), Bonds' record-breaking 73-homer season in 2001, his slamming career home run No. 700 this year. Aside from the Boston Red Sox feel-good World Series triumph in 2004, the big events have been about players who entertain with brute strength.

There's little to indicate that the latest drug scandal will cause fans to hesitate before buying tickets, especially to games starring Bonds. Last season, as steroid rumors swirled, MLB set an all-time attendance record. And the Giants, with Bonds as the star attraction, racked up the second-highest attendance in the National League and were the top-drawing NL franchise on the road.

Days after the grand jury leaks, MLB and baseball marketers continued to pitch Giambi and Bonds, and trading-card company Topps Co. announced the signing of Bonds to a two-year deal that industry sources say could be worth more than \$1 million. "We don't have a crystal ball, but we don't feel [the scandal] will have a major impact on the way fans view him," says Topps Vice-President Warren Friss.

MLB also continues to push an array of souvenirs tied to Giambi and Bonds. A week after the scandal broke, the MLB.com fan shop offered a bronze Giambi medallion, a Giambi street sign, and a Barry Bonds Christmas tree ornament for \$14.99.

As shoppers load their carts, MLB owners and the Major League Baseball Players Assn. will be putting teeth into a drug testing program. After long resisting vigorous testing, union chief Donald Fehr on Dec. 7 announced support for tough policies, and strict new rules are expected to be in place for Opening Day. But in the Be Careful What You Wish For Department, one large question looms: Will fans—especially younger ones weaned on Arnold-size action heroes and video games—find game played by mere mortals less exciting entertainment?



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EDITED BY MONICA GAGNIER

HEADLINER

REUBEN MARK



PROFIT AND FLOSS

Reuben Mark is famous for his longevity—and his consistency. In his 19 years as chairman and CEO of Colgate-Palmolive, he has rarely stumbled at delivering consistent earnings growth.

But following Colgate's 10% fall in third-quarter earnings, Mark is moving quickly to overhaul the consumer-products giant, which has become an innovation laggard and an advertising dullard. He's jettisoning the laundry suds business to focus on oral care and higher-margin products. Twenty-six factories will close and 4,400 jobs will be cut. The expected savings of \$300 million per year will be plowed into product development and advertising, where rival Procter & Gamble outspends Colgate 5 to 1. Wall Street liked what it heard: It pushed Colgate shares up 8.2% on Dec. 7, to \$50.07.

Mark, 65, remains cagey about succession. Still, he says he is launching a "four-year business-building and profitability-increasing effort." Hardly the words of a chief executive with one foot out the door.

—David Kiley

A BREAK FOR CLEAN AIR...

The U.S. may be moving closer toward taking real action on global warming. On Dec. 8, a long-awaited report from the **National Commission on Energy Policy**, a bipartisan group created by the Hewlett Foundation and partners, called for mandatory caps on emissions of greenhouse gases. The report advocates everything from boosts in auto fuel economy and renewable energy to more diverse supplies of oil and gas. With a membership that includes former ConocoPhillips Chairman Archie Dunham and other conservatives close to the Bush Administration, the group hopes to break the logjam in Washington.

...AS DETROIT FIGHTS BACK

The auto industry has decided to fight California's efforts to regulate greenhouse gas emissions. The industry's lobby group, the Alliance of Automobile Manufacturers, along with **General Motors, Ford, Chrysler**, and **Toyota** and a few others, have filed a lawsuit in federal court in Fresno, Calif. They're challenging a rule enacted by the **California Air Resources Board** in September that would force the industry to cut carbon dioxide emissions by about 30%, starting in 2009. Since CO₂ emissions can only be reduced by boosting fuel economy, the industry claims that California's law is effectively a fuel-economy regulation. The carmakers may have a case. The **U.S. Environmental Protection Agency** ruled in September, 2003, that CO₂ can't be regulated as a pollutant. But California

contends that its right to enforce its own air quality regulations, which predate federal rules, is guaranteed by the federal Clean Air Act.

LAZARD EYES A LISTING



Truce or dare? On Dec. 6, **Lazard** Chairman Michel David-Weill finally agreed to permit chief Bruce Wasserstein (above) to move forward in taking the firm public. But if New York's brash dealmaker fails to list shares of Lazard, one of the last private investment banks, by the end of 2005, his contract will end prematurely. David-Weill hired Wasserstein in 2001 to run Lazard with an employment pact that ends in 2006. If Lazard goes public, the firm will have to dole out a large chunk of the money raised to buy out David-Weill and other partners.

CALPERS COMES CLEAN

The **California Public Employees' Retirement System**, the nation's largest pension fund, will now reveal the size of the fees it pays hundreds of money managers, including such well-known firms as the **Carlyle Group** and **Kohlberg Kravis Roberts**. CalPERS will also disclose the returns from each manager. CalPERS will release the data to settle a

lawsuit brought by a nonprofit coalition that argued the fees are public data. Money managers doing business with the fund are among the largest campaign contributors to politicians who either appoint representatives to the CalPERS board or sit on the board.

ET CETERA...

➤ **Credit Suisse Group** plans to streamline the operations of its investment bank **Credit Suisse First Boston**.

➤ **Nortel Networks** will begin filing its delayed financial reports on Jan. 10.

➤ **Martha Stewart** will team up with reality-show guru Mark Burnett to host a daily TV show in fall 2005.

CLOSING BELL

Shares of **Sirius Satellite Radio** are falling back to earth. After tripling since deejay Howard Stern's August signing, the stock fell 23%, to \$6.90, on Dec. 8. Wall Street is worried about big payments for programming and low average revenue per subscriber.



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Shared at 2:15



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- MP3 player and ringtones
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by the parent of operating companies who purchased over \$5 billion of American commodities last year.

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EDITED BY RICHARD S. DUNHAM

The Man Who Drove a Tank Through Congress

ON CAPITOL HILL, THE NAME Duncan Hunter has never been mentioned in the same breath as legendary House Armed Services Committee bosses such as Carl Vinson and L. Mendel Rivers—least until now. But by holding the intelligence-reform bill hostage until the Bush Administration heeded his concerns,

the Southern California superhawk proved that his brand of pit-bull politics can win influence—if not necessarily friends—in Washington. “Compromise is not a word in his vocabulary,” says John D. Macs, president of the Council for a Livable World, a Washington arms-control group. Despite overwhelming bipartisan support for the spy reforms recommended by the 9-11 Commission, Hunter deployed high apocalyptic rhetoric about potential risks to soldiers to stymie the Administration-backed bill. His persistence won the conservative Republican language protecting the military chain of command, even though his critics insist the legislation never threatened it.

Warriors’ Advocate

VETERAN whose has served two tours of duty in Iraq, Hunter was swept into the House in Ronald Reagan’s 1980 landslide. Since then he has climbed up the Armed Services ladder, building expertise and wielding clout even before he became chairman in 2003. Skeptical about Defense Secretary Donald H. Rumsfeld’s plans to let technology replace troops on the ground, Hunter opposed quashing Rummy’s initial plans to shrink the Army’s size. With undermanned troops struggling to put down the insurgency in Iraq, “it’s clear Duncan Hunter is right,” says Loren B. Thompson, chief operating officer of Lexington Institute, a conservative think tank. Hunter’s goal is always clear. “Everything he wants is for the war fighter,” says representative Curt Weldon (R-Pa.), a longtime rival on Armed Services. And

there’s no end to what he wants for the war fighter, from more vehicle armor to more body armor for GIs to greater support for Lockheed Martin Corp.’s F/A-22 Raptors.

“Total Nonstarter”

HUNTER’S INSTINCTS put him on a collision course with Senator John McCain (R-Ariz.) over the ill-fated Boeing tanker lease deal. The Armed Services chairman worries that the military isn’t replacing tankers and other aging gear fast enough—and wants the replacements to be built by U.S. companies like Boeing Co., not such European outfits as Airbus. “It’s a total nonstarter to give the French hundreds or thousands of American jobs to build a part of our national defense system that they aren’t willing to support,” snaps Hunter, who backed Pat Buchanan’s 1996 run for President.

The chairman’s next test will be his handling of defense spending. With deficit hawks looking for ways to slash the deficit, Hunter will man the ramparts to prevent

Pentagon cuts. When House Budget Committee Chairman Jim Nussle (R-Iowa) tried to pare one-half of one percent of Bush’s defense request, Hunter enlisted nearly three dozen

Republicans to vote against Nussle’s budget. The Iowan backed down. Among spending priorities, Hunter insists, “defense clearly has to take precedence.” If the intelligence-reform fight is any indication, the battle between budget hawks and defense hawks will be one bruising brawl. But this time nobody is going to underestimate the new heavyweight running the Armed Services Committee. ■

—By Stan Crook



SCARE TACTIC Hunter’s rhetoric stalled the intel-reform bill

CAPITAL WRAPUP

WILL BUSINESS GET A FRIEND AT THE SEC?

CORPORATE ATTORNEY **John Olson** has emerged as a business favorite to succeed **Harvey Goldschmid** as a commissioner at the Securities & Exchange Commission. Like Goldschmid, Olson is a Democrat. But the senior partner at Gibson, Dunn & Crutcher is viewed as having more real-world experience than investor champion Goldschmid, who plans to return to Columbia law school by next summer. Olson, a governance expert, counts the Business Roundtable and audit committee of Coca-Cola (page 76) among his clients. The California native says he hasn’t been contacted by the White House but would consider taking one of the SEC’s two Democratic seats. Another contender who gets high marks from business is **Cary Klaffer**, Intel’s vice-president for legal and government affairs.

THE REPORTS OF SNOW’S DEPARTURE HAVE BEEN...

AFTER ALLOWING Treasury Secretary **John W. Snow** to twist in the wind for a week and half as rumors swirled of his imminent departure from the Cabinet, the White House announced on Dec. 8 that the embattled policymaker would stay on. Snow, who spent his first two years tirelessly promoting tax cuts hatched before he took the job, is looking forward to putting his own mark on the Social Security and tax reforms Bush has teed up for his second term. But the Treasury’s chief’s ability to do that has been damaged by the sniping he endured from GOP insiders as his fate was being decided. The White House refused to say how long Snow would stay on, but the betting is that he’s likely to step down sometime next year.

MULTINATIONALS

THE RAJA OF STEEL

Lakshmi Mittal is building the biggest steel company on earth. What will he do when the glut comes?

THE DABROWA GORNICZA steel plant near Katowice, Poland, is a cathedral of Soviet-era rust belt industry. An enormous building, lit by skylights and navigated by catwalks, houses a hot rolling mill more than half a mile long. The heart of the operation is a giant conveyor belt that trundles steel bars, glowing bright orange with heat. Sparks fly and steam rises when the bars hit rollers that squeeze the metal into I-beams and rails.

This part of the world is littered with dinosaur steel plants like Dabrowa. Such Communist relics looked doomed to extinction not long ago, but under all that corroded metal, Lakshmi N. Mittal spied gold. The Indian-born steel baron has been building his own Jurassic Park, picking up five plants in Poland and the Czech Republic in just two years, to add to a collection spanning four continents.

TOP OF THE HEAP

NOBODY OUTSIDE the steel industry paid much attention to Mittal's sad sack of properties until October. That's when Mittal Steel announced a \$4.5 billion deal to buy International Steel Group (ISG), a package of five once-bankrupt steel companies assembled by U.S. workout specialist Wilbur L. Ross Jr. The share price of Ispat International, a publicly traded Mittal company, jumped 27% on the news. Ispat will be merged with Mittal's privately held LNM Holdings, to form Mittal Steel Co., which will take over ISG. Assuming the transaction is finalized on schedule in early 2005, Mittal will stand at the helm of the world's No. 1 steel company, with annual shipments of 52 million metric tons, some \$32 billion in annual sales, and 2004 pro forma profits in excess of \$6.8 billion. Guy Dollé, the chief executive of Luxembourg-

based Arcelor, dashed off a congratulatory e-mail as soon as he got wind of the deal—a magnanimous gesture considering Mittal had just deposed him as steel king. “Mittal has had a vision for the industry that goes back a long way, well before the majority of his peers,” says Dollé.

That vision, in one word, is consolidation. The word steel connotes strength and permanence, but for decades the industry has been fragmented, financially weak, and plagued by oversupply. Coal and iron ore producers and customers such as carmakers were far stronger than steelmakers, and dictated terms. Not surprisingly, each downturn sent waves of companies to the wall.

Many steel execs thought Mittal was deluded as they watched him snap up distressed mills from Trinidad to Kazakhstan. But through the years, Mittal patiently perfected his techniques of reviving plants by making quick capital injections, dispatching emergency teams of managers to stabilize factories, and exploiting the efficiencies in purchasing and expertise that come with an expanding network of mills. The global market has favored Mittal, too. A doubling of steel prices in the last year, thanks to a strong world economy and insatiable demand from China, is now making him look like a genius.

Still, it took the ISG deal to truly vindicate Mittal's vision. “We need much larger companies, healthier companies. They will bring sustainability to the industry,” says the soft-spoken steel mogul in his

modest offices on London's Berkeley Square. “What I am hoping is for consolidation to continue.” There's certainly room for more: Even after acquiring ISG, Mittal will have just 5% of the 1 billion metric ton world market for steel.

Questions linger about the long-term ability of his strategy, which depends on success in the U.S. and on the group's ability to thrive even in a downturn. What's more, Mittal will have to spend about

billion over the next few years to upgrade and maintain all those aging plants. Yet the massive deal is a triumph for Mittal, who has come a long way since his birth in the Sadulpur district of India's Rajasthan state in 1950. His father started a steel business in Calcutta decades ago. But after setting up his own Indian minimill in 1971, the eldest son struck out on his own, opening up a mill in Indonesia in 1975. On that tiny foundation, Mittal has built an empire spanning 14 countries.

With the news of the ISG deal, Mittal's net worth has soared to around \$22 billion. The steel magnate is already a British tabloid staple. Mittal is said to have paid \$130 million for a mansion in London's West End and to have spent millions on the nuptials of his only daughter—a six-day affair, including a grand bash at Versailles.

Now, Mittal is ready to make his name in the U.S. Ispat already has a presence stateside through its \$1.2 billion acquisition of Inland Steel Co. in 1997. Overnight the ISG deal catapults Mittal

Vital Stats

The combination of Mittal Steel and International Steel Group is the world's No.1 steel producer.

SHIPMENTS*
52
MILLION METRIC TONS

OPERATING INCOME
\$6.8-7.0
BILLION

REVENUE
\$31.5
BILLION

NET DEBT
\$3.2
BILLION

Data: Company reports

The Mittal Method is less about steel than about smart practices

analyst at J.P. Morgan Chase & Co. in New York. Gambardella thinks Washington will welcome more concentration in the industry because it will reduce the need for government intervention to protect U.S. steel companies from imports.

Industry insiders wonder, though, whether Mittal will be able to realize the huge savings at ISG that he is accustomed to achieving in emerging markets. ISG already has gone through a cost-cutting exercise under Ross, who offloaded his companies' retiree liabilities onto the government. "I don't think he's going to drive the operating cost structure a lot further," says Keith E. Busse, president and CEO of Steel Dynamics Inc., a Ft. Wayne (Ind.)-based minimill.

But Mittal's executives are convinced that they can still wring out more costs from ISG, whose plants are hardly state-of-the art. The company logged 8.6% margins for the first nine months of

BARGAIN HUNTER
Mittal now has
factories on four
continents

from a bit player to the top of the heap. Ross admits his own set of mills looked tiny next to Mittal's empire, and that was one of the reasons he decided to sell: "It would take very many years to approach what they had and at the end of the day we would still be in an inferior position." Mittal wants to integrate his eight U.S. mills—most clustered around the Great Lakes—to mine regional economies of scale, a formula he's applying in Eastern Europe as well. By running the facilities as single units, he seeks to extract better margins from suppliers of iron ore, coal, and

electricity. And with the plants no longer competing against each other, Mittal should be able to negotiate better prices and guarantee clients a stable source of supply. "Our customers and suppliers are very happy that we are consolidating the business in the U.S. This kind of merger sees strong and financially healthy companies emerging," says Mittal. The new Mittal Steel Co. will have about 40% of the U.S. market for flat-rolled steel used in autos. "The industry will have more pricing power over autos than it has had in decades," says Michael F. Gambardella, an

2004, compared with a combined 27.5% at Ispat and LNM. A source close to the company says more than \$1 billion a year in savings and revenue gains can still be found. A new agreement with ISG's union will allow Mittal to cut back on shop-floor workers and supervisors. "He's a hard-nosed entrepreneur who obviously has some skill at building a steel company," says Leo W. Gerard, international president of the United Steelworkers of America.

Upgrading ISG looks relatively easy to Mittal and his execs. After all, they often



POLAND PLAN
Nearly \$800 million will go into upgrades

performed major surgery on the plants they acquired in emerging markets. The changes being wrought on the Polish plants purchased in March are prime examples of the Mittal way. Mittal beat out U.S. Steel Corp., bidding \$351 million for a controlling stake in Polskie Huty Stali, a group of four companies close to bankruptcy. He agreed to take on \$1.27 billion in debt and pledged about \$770 million in fresh capital.

Then it was time to apply the time-tested Mittal Method. A 15-strong SWAT team, many of them Indian, was dispatched to Silesia. The first priority was stabilization: The Polish plants weren't even generating enough cash to pay for supplies or employee benefits. As agreed, Ispat injected about \$100 million in emergency capital.

Then new Chief Financial Officer Augustine Kochuparampil began calling on angry creditors and suppliers to regain their confidence—including the gas company, which was threatening to turn off the taps. One by one he won them over by promptly paying fresh invoices and working out an installment plan to pay off back debt. Kochuparampil also cut back on

barter deals. Meanwhile, plant staff is being reduced to 10,000 from 14,500, through a combination of buyouts and attrition. Workers give the changes mixed reviews. "At least we are being paid on time," says Slawomir Leksztyn, a foreman at Dabrowa. But he says the pay—about \$900 a month—is poor compared with Mittal plants in Germany and France.

A CONSOLIDATED FUTURE

THE THERAPY IS WORKING: Just eight months after being acquired, the Polish operations are profitable, earning \$121 million a month before interest, depreciation, and taxes, according to a Mittal exec.

Investors will now find it easier to put their money alongside Mittal's, whose holdings will be listed on the New York Stock Exchange. Ispat, traded on the Amsterdam Stock Exchange and the NYSE, groups most of the family's Western operations, accounting for about 40% of revenues. The stock has risen from \$7 a year ago to more than \$36 today. More prof-

With 5% of the world market, the steel giant has room to grow

itable LNM Holdings, a private company, has the non-Western assets. In a complete deal, Ispat will acquire control of LNM and the resulting Mittal Steel Co. will acquire ISG in a 50-50 cash and shares transaction. Mittal's eldest son, Aditya, will be president and chief financial officer. The 28-year-old Wharton School graduate has a big hand in negotiating the ISG deal.

Mittal will doubtless keep seeking ways to expand. Dollé of Arcelor thinks that in 10 years the industry will be dominated by four or five majors, including Mittal, Arcelor, Shanghai Baosteel Group, a Japanese entrant, and, possibly, Posco in South Korea.

Mittal still has holes to fill in his portfolio. The big priority is China—a tough nut to crack. He recently launched a \$10

million finished steel operation in Liaoning province. But acquisitions are getting more competitive. Although Mittal has low cost, big capital commitment could be a stretch during a downturn. In the last steel slump, his companies—including Inland—struggled. Mittal figures that consolidation and an industry focus on profits over volume will

head off supply gluts in the next crunch. Others, including some Mittal insiders, think the next downturn could be vicious. A wild card is China, which in the last decade has added capacity equal to 90% of the eurozone.

Still, even competitors concede that compared with just four years ago, Mittal now has a broader-based group with margins that are the envy of the industry. When Mittal vows to do a deal, his rivals have learned to listen. "He's a man of his word," says Daniel R. DiMicco, CEO of Charlotte (N.C.)-based Nucor Corp. And Lakshmi Mittal hasn't finished yet. ■

—By Stanley Reed in Katowice, with Michael Arndt in Chicago

How to Turn Around a **Steel Plant** in Six Easy Steps

With at least a dozen acquisitions under his belt, Lakshmi Mittal has a tried-and-true plan for restructuring new properties

SWAT TEAM	LIQUIDITY FIX	DEBUG	PRODUCT MIX	INTEGRATE	PRUNE
Remove most existing managers and replace with Mittal executives to get the company running on a commercial basis quickly	Reestablish credit with suppliers to assure a steady flow of raw materials. End barter arrangements that beget corruption and crimp cash flow.	Bring in Mittal technicians to improve operations such as rolling mills and blast furnaces. Rework maintenance schedules to reduce downtime.	Shift to production of higher-value goods such as cold-rolled steel and galvanized sheets. Try to sell to end users rather than middlemen.	Plug new facilities into the global network. Form regional groups to boost purchasing power and prevent plants from competing for business.	Close or sell off noncore subsidiaries, from catering to hotels. Gradually cut back staff, possibly through buyout programs.

COMMENTARY

BY JASON BUSH

The Bigger Gazprom Grows, The Further Russia Backslides

its Yukos deal goes through, serious market reform is endangered

IT HAS BEEN THE talk of Moscow, an event that is already seen as a defining moment in the history of Russian business. The scheduled sale on Dec. 19 of Yuganskneftegaz, the main production subsidiary of Russian oil company Yukos, will not just mark the final destruction of Yukos, which is being torn apart by the government to pay massive tax arrears of an implausible \$26 billion. It will also mark the biggest nationalization of private property in Russia since the end of communism. That's because Yugansk looks almost certain to be acquired by Gazprom, the state-dominated gas giant. "Gazprom has been ordered by the Kremlin to bid," says Christopher Weafer, head of research at Russia's Alfa Bank.

This is a bid Gazprom officials vowed they would never make—until they changed their tune on Nov. 30. The price will be \$8.6 billion, and overnight Gazprom will acquire oil reserves of 1.63 billion barrels, equal to 17% of Russia's total. Gazprom's revenues of \$34 billion will be boosted an extra \$7.5 billion by the deal, which comes hot on the heels of Gazprom's merger with Sibneft, the state-owned oil company. Gazprom will end up with almost one-quarter of Russia's oil reserves after merging with Sibneft and acquiring Yugansk. There may be more deals down the road. Gazprom confirmed that it has received a recommendation from Deutsche Bank "to buy companies such as Sibneft, Surgutneftegaz, and Yuganskneftegaz." If it ends up buying all three, Gazprom will end up not only owning most of Russia's gas but also 40% of oil reserves. Gazprom declined to comment.

What would this agglomeration do to Russia? It would probably mark the end of serious reform under President Vladimir Putin—reform the country needs more than ever. Despite record high oil prices, the economy grew an annualized 4.5% in November, well below the 7.6% clocked in November, 2003. Domestic investment plummeted, particularly in oil, largely because of the attack on Yukos. Since the sale of Yugansk was announced on Nov. 19, the stock market has lost 15% of its val-



ue. Government reformers are up in arms. On Dec. 1, German Gref, Russia's Economic Development & Trade Minister and the chief architect of Putin's economic reform program, condemned the likely sale of Yugansk to Gazprom. "Where we have competition, state participation is inappropriate," he said.

Reformers' protests, however, are not likely to change the mind of Putin or his ex-KGB advisers. That's too bad, because Gazprom's performance is hardly a great advertisement for expanding its economic role. While Russian oil companies—most of them private—have managed to boost output by 50% since 1998, Gazprom's production has fallen by 1.6%. Gazprom's revenues have risen by some 70% since 2001, the year Putin appointed Alexei B. Miller, a close associate, as Gazprom's chairman. But that increase has been offset by a 99% rise in costs, according to Moscow investment bank United Financial Group. Inefficiency is the main reason. The Organization for Economic Cooperation & Development says employment in Russia's gas industry—which mostly consists of Gazprom—increased by over 80% from 1997 to 2003. Productivity dropped by 40%.

Some still think the impact of Gazprom's expansion will be limited. In this view, Putin's objective was to curtail the excessive power of oligarchs such as Mikhail B. Khodorkovsky, Yukos' major shareholder. Gazprom's acquisition of Yugansk is merely a convenience, since no one else could bid. Maybe. But Gazprom will end up big, powerful, and scary—not what Russia needs. ■

BURIED TREASURE
Tapping natural gas in Siberia

SIGNS OF TROUBLE

Gazprom's costs are going up faster than its earnings

Increase in earnings 2001-2004*

32%

Increase in costs 2001-2004*

99%

*2004 figure is a forecast

Data: Gazprom

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EDITED BY ROSE BRADY

Who'll Survive the Textile Trade Shakeout?

ON JAN. 1, 2005, HELEN MORLEY, a Manhattan designer who markets to retailers such as Saks Fifth Avenue, plans to shift 75% of her production from New York to a factory in China. She'll have her 13,000 dresses air freighted by United Parcel Service, which on Dec. 2 said it was buying part of Chinese state-owned delivery

service Sinotrans Ltd. in anticipation of a surge in business. Morley figures she'll cut production costs by 50%. "All the designers are looking to China now. The small business ties to Chinese industry are going to explode," she says.

Although Morley employs just 20 workers, her move is part of a revolution in the global clothing industry. With the new year, three decades of quotas on U.S. and European textile and apparel imports will become history—meaning companies will be free to source from the cheapest suppliers. Some 30 million jobs worldwide could be affected, including an estimated 650,000 in the U.S. Developing nations in Asia, Africa, and Central America that benefited from quotas will have to compete with two emerging giants, China and India, which boast low wages, modern factories, and strong infrastructure. The Sino-Indian share of the \$60 billion U.S. clothing import market could more than triple, to 65% in five years, the World Trade Organization says. The result could be mass unemployment in countries from Honduras to Bangladesh.

"The developing countries are doomed," says Clyde V. Prestowitz, president of the Economic Strategy Institute, a Washington think tank.

Worried garment producers are scrambling to prepare for the new era. One strategy: postpone the pain. Some 50 governments are backing efforts by the U.S. industry to persuade Washington to limit some Chinese clothing imports for up to three more years. But it's not clear that the administration will grant the extension,

which is opposed by retailers, such as J.C. Penney Co., that buy from China.

A stronger defense has been mounted by five Central American nations and the Dominican Republic. They've inked a preliminary Central American Free Trade Agreement (CAFTA) with the U.S. that would lower U.S. tariffs on imported textiles and clothing—now 16% to 36%—to zero if U.S. cloth or yarn or locally made fabric are used. Those imports would have an edge over garments subject to tariffs. "Everything depends on CAFTA approval," says Jesús Canahuatý, head of the Honduran Maquiladora Assn.



LOSER? Vietnam's manufacturers are cutting prices to keep clients

orders. Cambodia is hoping its good labor practices will keep attracting orders. But Roger Tan, managing director of Phnom Penh's Thai-Pore Garment Manufacturing Co., expects buyers to demand price cuts of up to 20%.

Perhaps Pakistan, with \$8 billion in textile exports last year, has the best chance to survive the shakeout. After investing more than \$2 billion since 2000 to modernize factories, Pakistan expects textile exports to rise to \$13 billion within three years. But most developing countries need to brace themselves. The pain is only beginning. ■

—By Paul Magnusson in Washington, with bureau reports

GLOBAL WRAPUP

TIGHTENING ISRAELI-EGYPTIAN TIES

FOUR FREE-TRADE zones will be created in Egypt as a result of a deal to be signed by Israel, Egypt, and the U.S. on Dec. 14. Under the accord, goods can be exported to the U.S. duty-free as long as 35% of the content results from cooperation between Israeli and Egyptian companies, and 8% is Israeli. Bilateral trade between Egypt and Israel is just \$44 million, but officials expect the figure to more than double as a result of the pact. Egypt is also negotiating to export \$2.5 billion worth of natural gas to Israel over 15 years. And there has been a political thaw: The two governments recently exchanged prisoners and are talking about reviving Israeli-Palestinian peace talks.

MORE TROUBLE FOR VIVENDI'S EX-CEO

FRANCE'S STOCK market regulator fined Vivendi Universal and its former chief executive officer, **Jean-Marie Messier**, \$1.3 million each for misleading shareholders from 2000 to 2002. The Financial Markets Authority ruled on Dec. 7 that Messier had provided inaccurate information on Vivendi's indebtedness, cash flow, and financial outlook. Messier, who now runs an investment advisory firm in New York and Paris, is appealing the decision. The same day as the French ruling, current Vivendi CEO **Jean-René Fourtou**—who has cut company debt from \$27 billion to about \$7 billion since Messier's July, 2002, ouster—said he would hand over his post to Chief Operating Officer **Jean-Bernard Lévy** in April. Fourtou will chair the company's newly organized supervisory board.

COMMENTARY

BY MICHELLE CONLIN

Take a Vacation from Your BlackBerry

Gadgets may or may not boost productivity, but they sure boost errors and stress

MARTY KOTIS IS one of them—the people of the handhelds. The CEO of Greensboro real estate development company Kotis Properties carries not one but two cell phones: a Bluetooth-enabled Motorola V710 and a Treo 600 (soon to be upgraded to a 650). That's so he can

talk on one while simultaneously checking and sending e-mail on the other. His green BMW 740 is equipped with two LCD screens mounted above the front and back seats so he can hold mobile videoconferences. On the bimmer's backseat bulges his 50-lb. go-bag complete with a laptop, five external drives, an iSight camera, a digital camera, a digital video recorder, and a Bluetooth printer. At stoplights he downloads everything from aerial photographs of new site locations to songs like *Over and Over* by Tim McGraw and Nelly, which he plays wirelessly on his stereo through his iPod. "Sometimes people honk," Kotis says.

In Tokyo they call them the *oyayubi sadai*—the Thumb Generation. Here in the U.S., the multitasking mobs don't yet have an official moniker. Instead they are known by their crackBerry thumb splints and their Treo trances, their faces glued to screens as the sounds of *Ice, Ice Baby* ringtones fill the air. Text messages are creating a new office shorthand: "Tx. Hi yu si on confcall 330\$." (Translation: "Thanks. Why don't you sit in on the conference call at 3:30?") In Congress, BlackBerries—the ultimate in post-boom cachet—have turned a slew of starched staffers into keyboard Cassanovas, "blirting" (flirting) across hearing rooms. CNBC anchor Alan Murray even confessed to viewers that he uses his handheld in church.

There's no doubt that the multitudes of gadgets, many of which claim most-lusted-after status on Christmas wish lists, have enabled us to be productive in ways we never dreamed. They also make us not so productive, like the time Omar Wasow, executive director of BlackPlanet.com, got an urgent text message during a high-level meeting that read: "Nicole

Kidman with yoga mat in Union Square. Right now." The question, then, remains: Are these devices really delivering on the promise to heighten productivity? Can gadgets enable one employee to do the work of two?

To those in academia who study our use of them, the answer is far from a resounding yes. The idea that gadgets always make us more efficient "is a scam, an illusion," says David Greenfield, director of the Hartford-based Center for Internet Studies. That's because at their heart, gadgets enable multitasking. And a growing body of evidence suggests that multitasking can easily turn into multislackening. It also increases errors, short-circuits attention

spans, induces air-traffic-controller-like stress, and elongates the time it takes to accomplish the most basic tasks by up to 50% or more, according to University of Michigan psychology professor David Meyer. At the same time, scrolling through e-mail during business lunches and punching out text messages during meetings can kick in our dopamine-reward system, says Meyer, unleashing a pleasure-inducing hit that for an estimated 6% of Internet users has become clinically addictive.

Gadgets also trigger cognitive overload, says Harvard Medical School psychiatry instructor Dr. Edward M. Hallowell, contributing to a new epidemic he calls ADT: attention deficit trait. All that toggling back and forth "dilutes performance and increases irritability," says Hallowell, causing steady managers to become disorganized underachievers. "I'm not pro-con technology, but this is a challenge we've never faced before."

As gadgets enable everyone to generate more and more work, raising the volume of material people have to process, the flywheel moves faster and faster. "At some point it becomes an insupportable loop," says Hamilton College anthropologist Douglas Raybeck.

We aren't built for "continually processing a great mountain of information." Thus signs of sanity are emerging: the Quiet Car on Amtrak. The buzzing "manner" mode on phones. Teenager-throwing cell-phone-free, no-text-messaging-allowed parties. And with all things technological, perhaps it's time for the executive class to take yet another cue from them. ■



A sign of sanity: The Quiet Car on Amtrak



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A Java Jolt for Dunkin' Donuts

CEO Luther has launched an ambitious growth plan. Can he take on Starbucks?

ALLIED DOMECQ PLC CEO Philip Bowman recruited Jon L. Luther to revive Dunkin' Donuts two years ago after complaining that the venerable chain had become a sleeping giant. Krispy Kreme Doughnuts Inc., with a cult-like following for its sugary doughnuts, was running circles around it. In coffee, Dunkin' hadn't even bothered to offer the lattes that gave Starbucks Corp. its buzz. And while it was powerhouse in the Northeast and mid-Atlantic, much of the U.S. was ignored. What about the rest of America?" Bowman remembers wondering. "Is there some reason that these folks in this white space [on the map] don't drink coffee or eat doughnuts?"

Luther was brought in from Popeyes Chicken & Biscuits, and these days, the 54-year-old chain is acting like it has swallowed a triple shot of its new fresh-brewed espresso. It has left the imploding Krispy Kreme in the dust, thanks in part to better execution and a strategy that stresses beverages rather than carb-laden doughnuts. It has begun an aggressive expansion that aims to triple Dunkin' outlets, to 15,000, within a decade or so. Now Luther's team is even daring to talk about taking on the coffeehouse *crème de la crème*. "We're every bit as good as Starbucks," insists John Gilbert, vice-president of marketing, who has brazenly launched ads claiming Dunkin' offers "A taste that Starbucks can't beat."

Advertising taunts aside, not even Luther believes Dunkin' Donuts can beat

Starbucks at its own hipster game. Rather, Dunkin' is building on its red-state coffee image, even though it's based in blue state Massachusetts. Starbucks popularized Italian espresso drinks. "But we offer more of an Americanized espresso, with a more mellow blend," says Luther. Similarly, while Starbucks baffles newcomers with its "tall, grande, or venti" cups, Dunkin' sticks to small, medium, and large, at prices some 25% lower. Luther is betting there are lots more coffee drinkers who want espresso drinks at lower prices without the jiggy atmosphere.

Filling a void left by the stalled Krispy Kreme and riding Starbucks' espresso coattails is making Dunkin' one of the hottest acts in fast food. Thanks to a 6.9% jump in same-store sales, and 423 new stores, U.S. sales surged 14% in the fiscal year ended Aug. 31. That's nearly three times the industry average for sales growth, according to Technomic Inc. And while Dunkin' has little in common with its British parent's core wine and spirits business, it is a cash machine. Dunkin' Brands—which includes the Baskin-Robbins ice cream chain and Togo's sandwich shops—accounts for about 9% of Allied's sales, but 14% of its total profit.

No question Dunkin's basic business model looks all the more attractive against its faltering nemesis Krispy Kreme. A year ago, Krispy Kreme's stock was soaring. But now the chain's fortunes have collapsed under the weight of mismanagement, overexpansion, and accounting probes. Meanwhile, Dunkin' is finding smarter ways to move the doughnuts. Increasingly,

The Coffee Break Gets Crowded

DUNKIN' DONUTS

U.S. STORES: 4,400, owned by franchisees.

BUSINESS BREAKDOWN: No. 1 in doughnuts, bagels, muffins. Over half of sales come from highly rated coffee, other beverages.

PROSPECTS: New espresso drinks are driving strong store growth. Limited presence in much of the U.S., and the store format is tired and unappealing. Strong franchisee base and high employee retention help service.

KRISPY KREME

U.S. STORES: 400-plus, company owned and franchised.

BUSINESS BREAKDOWN: The doughnuts are to die for, which is why they account for about 90% of sales. But it has no credibility in coffee.

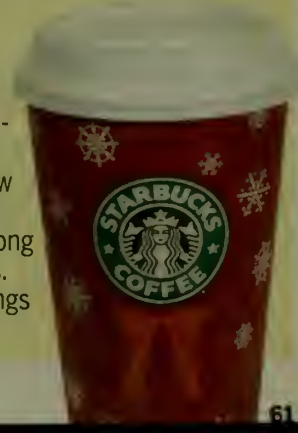
PROSPECTS: After meteoric rise and overexpansion, same-store sales are tumbling and profits have evaporated. Oversaturation of some markets has made KK doughnuts passé to many.

STARBUCKS

U.S. STORES: 6,000-plus, company operated and licensed.

BUSINESS BREAKDOWN: 78% of revenue comes from coffee and other beverages; food accounts for just 12%.

PROSPECTS: A master at creating an inviting retail experience, which commands premium prices. But execs concede same-store sales growth will slow to a 3%-to-7% pace, from strong double digits. Food offerings are weak.

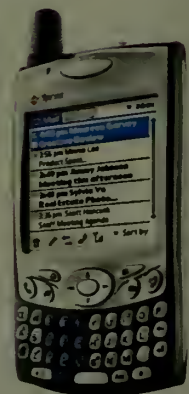


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Marketing Fast Food

LUTHER
Image-
booster



freshly made alternative to Red Bull and other energy drinks.

Luther's broader mission is to improve the image of Dunkin's coffee, and he's getting help. The December *Consumer Reports* rated Dunkin's ground coffee a "Best Buy," and far higher than Starbucks', which it found "burnt and bitter." Starbucks CEO Designate James L. Donald's retort: "Thirty million customers vote with their feet every week."

NO LUNCH BUNCH

KICKING DUNKIN' UP a few notches in coffee drinkers' minds is not as easy as getting the milk frothed right. Dunkin' has some star franchisees who build fiercely loyal customers with spotless stores and personalized service. But many franchisees fall short, and some stores are downright dingy. Also, Dunkin's shops are largely deserted before and after morning rush. Despite numerous attempts with sandwiches and soups, it has never made the transition to the lunch crowd. A store redesign is under way, but it will take years.

Dunkin's biggest opportunity is geographic expansion rather than a bigger menu. Currently, 80% of its sales come from just 34% of the U.S., and it's all but invisible in much of the Midwest, Southeast, and West. Dunkin' is invading four new markets—Cleveland, Charlotte, Tampa, and Cincinnati—and will enter four more over the coming year. U.S. COO Will Kussell, who's directing the expansion, predicts it will soon be opening over 500 stores a year, up from under 200 in 2001.

Ultimately, Luther's aim is to vault Dunkin' closer to the stratospheric performance of Starbucks, which has 40% more U.S. stores than Dunkin'. Rapid expansion has its perils, as Krispy Kreme discovered. To succeed, Dunkin' doesn't need to match its rivals sales pace. But it does have to find a flock of new well-financed franchisees willing to keep standards high. Then it has to persuade some of the millions still drinking the swill sold

at most convenience stores and gas stations to trade up. That strategy may not be as glitzy as Starbucks's Wi-fi connections, comfy couches and hip music, but it's as straight forward as an honest cup of coffee. ■

—By William C. Symonds
in Boston, with David Kiley
in New York and Stanley
Holmes in Seattle

**Dunkin's
biggest
opportunity
is in
geographic
expansion**

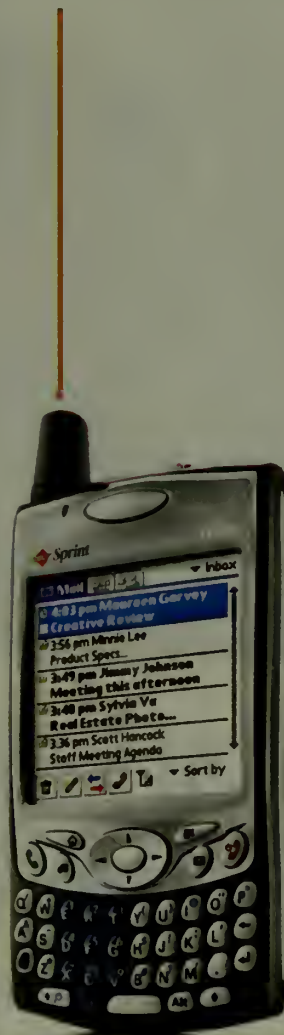
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GLOVES OFF Foreman preaches four times a week

in 1994 from Michael Moore the age of 45. But he admits that his second career as product endorser has brought him more fame, fortune, and personal satisfaction than dreamed possible.

As he lounged recently in a New York hotel room, Foreman was surrounded by reminders of his growing empire. A copy of his new cookbook, *George Foreman Indoor Grilling Made Easy*, rested on the coffee table. He was decked out in a brown shirt from the George Foreman Signature Collection, a clothing line that has been flying off the racks at the Cash Male Big & Tall retail chain ever since Foreman started advertising it in March. His latest grill, called the Next Grilling, hit store shelves in time for the busy holiday season. And with the help of a group of Chicago-area entrepreneurs, he launched a line of cleaning solutions called George Foreman's Knock-Out. The products are billed as safe for the environment, but Foreman

Marketing Champ Of the World

Almost everything George Foreman touches seems to sell. Will cleaning fluid?

IN 2002, GEORGE FOREMAN WAS in Memphis working as a boxing commentator for Home Box Office Inc. when he ran into a group of preschoolers walking down the street. Their teacher explained to the children that Foreman had won the gold medal in heavyweight boxing at the 1968 Olympic Games. One little boy refused to believe it. "That's the cooking man!" shouted the tot, referring to the

former boxer's promotions of his George Foreman grill. Says Foreman, laughing at the memory: "They don't even know me as the champion anymore."

That's a bittersweet reality for the 55-year-old athlete-turned-entrepreneur. Foreman loves to be recognized for his gold medal and his other boxing triumphs: defeating Joe Frazier in 1973 to become heavyweight champion of the world, and improbably regaining the title

clearly is the main selling point: his smiling face appears on every bottle, making him look strikingly like Mr. Clean. "I love selling," Foreman declares.

LOSING STRENGTH?

SKEPTICS CAUTION THAT if Foreman tries to conquer too many different product categories, he'll end up losing much of his selling punch. But when Foreman looks at his scorecard, he's not worried. Indeed, while many athletes have millions promoting products in TV ads, Foreman is one of the rare jocks to put his name on a panoply of non-sports-related products and actually get consumers to buy them. George Foreman is more than a name—it's a full-blown brand. The George Foreman Grill's manufacturer, Salton Inc., has sold 55 million grills since launching the product in 1983.

Marketing experts say Foreman's connection with consumers comes not from his achievements in the ring, but rather from his own remarkable personal transformation. Gone is the sullen, nasty boxer who showed up to fight Muhammad Ali in the famous "Rumble in the Jungle"

with a menacing German shepherd by his side. Foreman, who says he had a religious awakening in 1977, has since morphed into an ordained minister and cuddly father of 10. It's just the underdog story that makes people want to pull out their pocketbooks. "He's got that buttoned, twinkly-eyed thing going on," says Luzan Nanfeldt, a marketing consultant in Leonia, N.J. "He has a Santa Claus quality that's incredibly appealing."

Lucrative, too. Foreman won't say how much he has made as a product endorser, but he doesn't dispute a published estimate that his lifetime earnings are about \$240 million—three times what he earned in the ring. In 1999, Salton bought the rights to use his name and selling skills in perpetuity for \$127.5 million in cash and \$10 million in stock. It stands as one of the biggest endorsement deals for any athlete. And in retrospect, it looks brilliant. Under the original '95 deal, Foreman had a right to about 40% of the profits from the grills, which range in price from \$20 to \$150. At the height of his success, Foreman received \$4.5 million a month in payouts, says Salton CEO Leonhard Dreimann. But in the past few years, consumers have put off replacing their old Foreman grills, and Salton has struggled: It reported a loss of \$3.2 mil-

lion on sales of \$274 million in its most recent quarter.

Foreman's role in managing his brand involves much more than lending his toothy grin to packages and ads. He sorts through as many as 20 endorsement offers a week with the help of two of his sons, George Jr. and George III, who have taken on much of the responsibility in managing the Foreman brand. He tries all potential new products—gathering approvals from his wife and children—before allowing his name on anything. John Bellamy, CEO of Knockout Group Inc., says Foreman went so far as to put an ethics clause in Knockout's contract prohibiting it from selling the company to anyone involved in alcohol, tobacco, pornography, or gambling. Foreman doesn't want his businesses to conflict with the traditional religious values that he preaches four times a week at his church in Houston. "The most important thing to him is his image," Bellamy says.

The risk, however, is that Foreman's image may be spread too thin. In 2002 he

Foreman's endorsement earnings are estimated at \$240 million

contracted with an entrepreneur in Omaha to launch a line of meat products and other foods. Now Foreman is fighting to unwind that contract. He says in court filings the company, named George Foreman Foods, introduced products he didn't approve, such as coffee and "old frozen meat

products." Foreman and his lawyer declined to comment. Larry Humberstone, president of George Foreman Foods, says he acted within the constraints of the contract, and "we were very careful to validate the quality of the products." Nevertheless, George Foreman Foods has filed for bankruptcy protection.

GRILLS FIT

BRAND CONSULTANTS say the biggest risk Foreman is taking is pitching products that veer away from his "cooking man" persona. Obviously, grills fit, says New England Consulting Group founder Gary M. Stibel: "He looks like he grilled 1,000 burgers last night." But cleaning products? Stibel and other experts wonder if Foreman has the credibility to duke it out in a category dominated by huge companies with multibillion-dollar marketing budgets. "It's a lot tougher to compete with Procter & Gamble than it is with Weber," Stibel says.

Foreman discovered his talent for selling while in the midst of a boxing comeback at age 40. Relegated to fighting palookas in tiny towns, he was asked to tape a 10-second promotion for a local TV station in Florida. He grabbed the microphone, he recalls, and screamed: "I'm going to show the whole world that age 40 is not a death sentence! Watch me!" The fight sold out in seconds, and Foreman was asked to do another promo the next day—this time for 20 seconds. "That was selling," he says.

Foreman says he would love to fight again. But he would have to drop 25 pounds and squeeze in grueling 15-hour workouts between his preaching, advertising tapings, and personal appearances. "I just haven't been able to find that time," he says. "Too many promotions." To the growing legion of businesses that are counting on his goofy grin and magnetic personality to sell their products, George Foreman will always be the world heavyweight champion of pitchmen. ■

—By Arlene Weintraub in New York

BIO

George Foreman

It may be risky to pitch products that veer away from his "cooking man" persona

BORN Jan. 10, 1949, Marshall, Tex.

EDUCATION Earned a GED in the Job Corps, which he joined in 1965. Took up boxing there.

BOXING HIGHLIGHTS Won the Olympic gold medal in Mexico City, 1968. Defeated Joe Frazier to become pro heavyweight champion, 1973. Lost title to Muhammad Ali the next year in famous "Rumble in the Jungle." Made a comeback at age 38, lost a 1991 title fight with Evander Holyfield, then regained the title at age 45.

A CELEBRITY IS BORN Underdog status in his comeback and new jolly personality resulted in a short-lived sitcom, *George*, and made him a favorite endorser for McDonald's, Doritos, Meineke, and others.

CURRENT JOB Building and

pitching the George Foreman brand, which includes several grills, a line of clothing sold by Casual Male, and a collection of nontoxic household cleaning solutions.

MOONLIGHTING As an ordained minister, he preaches four times a week at his church in Houston. He says a vision of Jesus prompted his transformation from a mean fighting machine to friendly businessman.

FAMILY Married to fifth wife, Mary, for more than 21 years; five daughters, five sons (all named George), four granddaughters.

HOBBIES Reading history and biographies, riding and breeding his 60 horses.

FAVORITE BOOK *His Way: An Unauthorized Biography of Frank Sinatra*.



BusinessWeek online

For a Q&A with George Foreman, go to www.businessweek.com/extras

CASINO SOCIETY U.S. operators generate an estimated 70% of the global online



Can Online Betting Change Its Luck?

The feds are keeping the heat on offshore Web sites, but a global backlash is building

WHEN HE GOT THE subpoena, *Pro Football Weekly* publisher Hub Arkush didn't know whether to take it seriously. The U.S. Attorney in St. Louis was demanding that the Chicago tabloid turn over its accounting records, e-mails, and phone logs related to ads from online gambling outfits—ads that sports papers like *PFW* had run for nearly a decade.

What got the attention of Arkush's lawyers was an accompanying letter hinting that he could face felony charges. In September, 2003, Arkush caved: He pulled the ads, took a \$2 million revenue

hit, and laid off 22% of his staff. "It has been a pretty miserable year," he says. "We're not breaking any laws, but who wants to battle the Justice Dept.?"

Apparently not Discovery Communications, Infinity Broadcasting, or Clear Channel Communications, all of which yanked ads for online gambling after receiving similar subpoenas and letters. Indeed, Justice's sweeping offensive against overseas-based Internet gaming has squeezed everyone from credit-card issuers to the PR firms that defend gambling companies in the court of public opinion.

The Justice campaign has sent a chill through several industries despite the fact that there is no explicit federal law against online gaming—something lawmakers

want to remedy. In testimony last year, Deputy Assistant Attorney General G. Malcolm endorsed tools to combat online gaming, which he said damages fraud, money laundering, and underage wagering.

Now the \$7.4 billion online industry, which comprises thousands of sites outside the U.S., is back against what experts say is a heavy-handed and probably unconstitutional move on a free-market enterprise. Casino City Inc., a Las Vegas operator of Internet gambling portals, is suing for violating its First Amendment rights. Another Internet gambling company is hiring Washington lobbyists to burnish their

establish alliances with the \$70 billion U.S. wagering business, and tax lawmakers with a potential new source of significant tax revenue. "Our revenue is greater than Yahoo's. Our profit is greater than Amazon's. It's ridiculous," says Alex Czajkowski, marketing director for Sporting Bet PLC in London, which processed \$2.5 billion in wagers last year for a \$39.5 million operating profit.

While many in the U.S. still view online gaming as a matter of morals, the tiny nation of Antigua has managed to turn it into a trade issue. On Nov. 10, Antigua won a World Trade Organization ruling that the U.S. violates international trade rules by, among other things, allowing credit cards to be used for domestic gambling but not online wagering. Britain is set to liberalize online gaming rules and could allow its operators to accept wagers from U.S. customers.

For advocates of click-to-play, their argument could be right. All states but two allow some form of gambling, New Jersey is experimenting with an interactive online lottery, and an Idaho tribe last year won a court ruling allowing it to sell lottery tickets on the Web. Texas Hold 'Em is the national pastime, and World Poker Tournament players boast of using game Web sites to hone their skills.

U.S. casino operators say cybergambling is inevitable and reject Justice claims that the online industry is

fraud. "We frankly find attempts at prohibition to be very shortsighted," says Alan Feldman, senior vice-president of the MGM Mirage in Las Vegas. Its online gaming site on Britain's Isle of Man, mvgmmirage.com, folded last year after 21 months because it couldn't turn a profit. Part of the problem: Avoiding risk to its Nevada and Mississippi state casino licenses, the site rejected wagers from U.S. players, who make up an estimated 70% of the global online take. "It's clear the public is gambling online in ever-greater numbers," says Feldman. "The logical thing to do is legalize it, regulate it, and tax it."

LYING COMPANIES?

THE JUSTICE DEPT. shows no signs of backing down. "The gambling is taking place both where the better is located and where the worse is located," says one federal law enforcement official. "If anyone takes bets from residents in New York, they're doing business in New York." To get at the offshore sites, the agency is targeting U.S. companies that do business with them. The Justice Dept. levied a \$10 million fine against World Poker, and in April the feds seized \$3.25 million from Discovery—money paid to it to run ads for Tropical Paradise, a Costa Rican poker site. Under pressure from the U.S. Justice Dept. and MasterCard and Visa began tracking online wagers; soon after (in a deal with New York Attorney General Eliot Spitzer), the nation's largest banks, including Citibank and Bank of America, stopped accepting charges for online bets.

In the near term, the industry's hopes are pinned on the Casino City case. But even if Casino City loses, industry lawyers say other suits are waiting in the wings. They concede that Justice has put the brakes on growth but say that in the long run U.S. policy is unsustainable. "They're bullying a lot of companies into being afraid to do business with us," says Bob Myers, CEO of the Sports Gaming Players Network, a Las Vegas consultant. "But you can bully only so long before the little guy starts swinging back. And Antigua has taken the first swing."

Even with a WTO ruling in its pocket, Antigua has the clout of an ant. But Britain could be different. "[It] will be the first First World nation where there's really going to be a test," says Frank J. Fahrenkopf Jr., CEO of the American Gaming Assn., a trade group. Online gambling can only hope that global pressure, plus a possibly less righteous Justice Dept. under new Attorney General Alberto Gonzales, will be its lucky pair. ■

—By Lorraine Woellert in Washington

Q&A

'American Citizens Want To Gamble on the Internet'

BY ANY DEFINITION, BetonSports.com is a global enterprise. The Internet gambling site is based in Costa Rica, trades on the London Stock Exchange, operates out of Antigua, and takes wagers from anywhere, online. It can't do business in the U.S., however, but that hasn't stopped stateside gamblers from placing bets on its site: Last year, they accounted for 98% of BetonSports' \$1.25 billion in revenue. BetonSports CEO David Carruthers finds that state of affairs curious at best. He talked by phone with Washington legal affairs correspondent Lorraine Woellert.

You recently met with lawmakers in Washington to talk up legalized online gambling. That's a pretty ambitious goal given that Congress has been seeking to impose even more restrictions.

I believe regulation brings protection, it brings certainty, and it brings quality operators to the game. It also allows the operator to invest with confidence and stimulate the economy. At the moment, online gaming is not regulated. It is, therefore, not taxed. The [U.S. government is] missing an opportunity for substantial revenue.

Yet you arrive on Congress' doorstep as lawmakers and the Justice Dept. are increasing pressure on the industry, not backing off.

The intent to cut off the oxygen supply to the industry has been unsuccessful. The fact is American citizens want to gamble on the Internet...that's not going to go away.

If 98% of your revenue already comes from the U.S., what exactly is the problem you're trying to fix?

We have 1.2 million registered customers in the United States who make 33 million wagers a year. Currently...I would be breaking the law if I had my operations in the United States.

At the same time, U.S. and state laws keep the big American casino brands out of the online gaming business. Isn't that a good thing for BetonSports?



CARRUTHERS Schmoozing on the Hill

On one hand, yes; on the other hand, no. If this business was in bright lights like Vegas, the marketplace would be a lot larger.

One reason for the heightened U.S. scrutiny of online gaming operators is the fear that they could be exploited by terrorist groups to launder money.

That's absolute hogwash. The very nature of the Internet is that every transaction is completely auditable from beginning to end. Every keystroke is logged into our system. We are more auditable, more scrupulously clean than the land-based operators.

Taking the Fear Factor Out of E-Mail

An obscure committee is proposing controversial rules for digital evidence

TORT REFORM IS A HOT topic again. Taking advantage of the most favorable political climate in years, business lobbyists are pushing for new federal laws that would mop up the asbestos mess, cap medical malpractice damages, and help companies steer class actions out of hostile state courts.

But there's another legal reform campaign that has attracted much less attention—yet could be more significant than any of these measures. It is Corporate America's effort to get the Judicial Conference of the U.S. (JCU), the obscure group that makes the rules governing lawsuits, to enact special new procedures for electronic evidence. This broad category of digital information includes spreadsheets, databases, memos, letters, PowerPoint presentations—and most important, the e-mail messages that have recently plagued so many companies in court.

Unlike some of the higher-profile items on this year's tort-reform agenda, which would affect a comparatively small number of companies, the JCU's proposed "e-discovery" reforms would influence nearly every big business in America. Digital evidence has revolutionized the litigation battlefield. It makes or breaks many lawsuits—and has increasingly turned early tactical skirmishes over custody of computer hard drives into some of the most important battles in a case.

That's why business and tort lawyers alike are amping up the rhetoric. Pro-reformers, including Microsoft, Wyeth, Exxon



Mobil, and several business groups, argue that e-discovery costs are spiraling out of control. Plaintiffs' attorneys insist that money has nothing to do with it. "A lot of material that emerged in cases like Enron would never have seen the light of day if these rules had been in effect," says Boston plaintiffs' attorney Anthony Tarricone. "The rules will undermine the essential purpose of litigation, which is to uncover the truth."

The proposed rules would give defense counsel a variety of new weapons. For instance, if a company accidentally turned over an e-mail cov-

ered by attorney-client privilege—a growing problem in today's massive data dumps—it would be easier to have the message erased from the record. And if digital information was deleted because of routine data-storage policies, companies would be shielded from punishment in most cases. This so-called safe harbor for what are often euphemistically called "document retention" programs is by far the most controversial proposal.

The soonest these provisions could be enacted is December, 2005. The tortious JCU approval process, which has been going on for nearly two years already, has several stages still to go. A series of public hearings is set to begin in San Francisco in January. And any new rules require the approval of the U.S. Supreme Court and Congress—though both bodies have a history of rubber-stamping JCU recommendations with little scrutiny.

BATTLE CRY

UNSUCCESSFUL in the early stages of the process, plaintiffs' attorneys plan to step up the counterattack. If the safe-harbor rule is adopted, they insist, companies will set their computer systems to automatically destroy electronic documents on frequent cycles and thereby insulate themselves from legal liability. They cite a recent incident involving Altria Group Inc. subsidiary Philip Morris USA Inc., which had a policy of deleting most e-mail messages more than 60 days old. U.S. District Court Judge Gladys Kessler determined that this resulted in the destruction of records relevant

to the federal government's ongoing corruption case against the tobacco industry—and in July levied a \$2.75 million fine. The new rules would not punish Philip Morris' actions, say many plaintiffs' attorneys. "Under the guise of document retention, companies are going to get rid of a lot of the big evidence problems they have had in the past," says Washington (D.C.) class-action lawyer Richard T. Seymour.

Coming at the end of a long period of business scandals, that sounds like a powerful battle cry. The main reason hasn't flown so far with the JCU subcommittee studying e-discovery is because companies also have a compelling story. Electronic discovery has proven to be much more expensive than old-fashioned paper discovery. The reason for the

THE STAT

**\$1.1
Billion**

Estimated billings of electronic-discovery consultants in 2005

Data: Socha Consulting, LLC

The truth in 3D

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errors by 80%.
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to market
70% faster.*
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counterintuitive phenomenon: People are producing a whole lot more information than ever before.

Executives who a decade ago kept all of their files in a few cabinets now have hundreds of times that amount of material stored in the computer. In many cases, e-mails have replaced hallway conversations. Then there's instant messages, Web sites, and many other types of new evidence that never existed before. A high proportion of this information is saved because it can be so cheaply stored. "It costs you more to think about whether to delete something than simply to leave it on your computer," says Microsoft Corp. deputy general counsel Tom Burt.

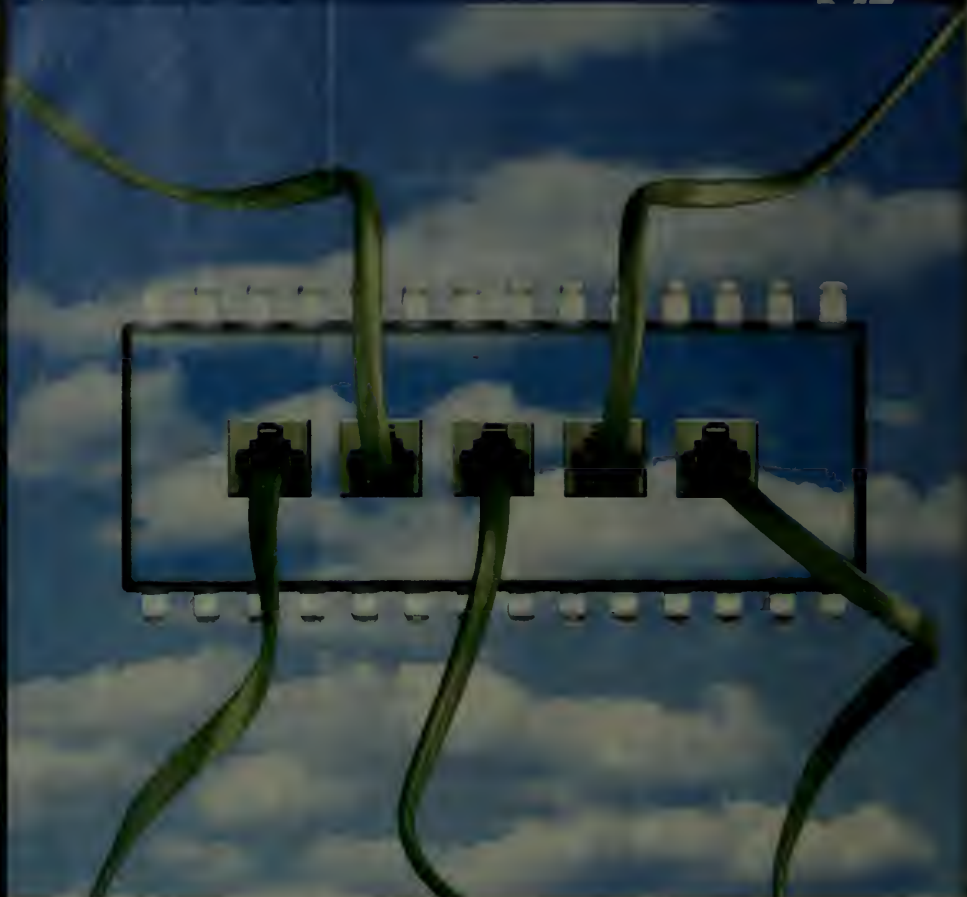
OLD TAPES, BIG HEADACHE

THEORETICALLY, ALL OF this information should be easily retrieved, but that's rarely the case. Old data are generally stored on old technology. Companies often have to hunt down archaic backup tapes in storage warehouses—then buy outdated machinery to read them. In extreme cases such efforts can cost several million dollars, says George J. Socha Jr., a former attorney and e-discovery consultant in Minneapolis.

Another big expense arises when judges order companies to preserve data created by certain executives—say, a pharmaceutical company's research-and-development staff in a defective-drug class action. That common practice requires managers to stop recycling backup tapes—something that can become quite expensive for large organizations with thousands of lawsuits and hundreds of computer servers. At an e-discovery conference in New York in February, one MobilExxon lawyer complained that the company spends \$1.9 million a month on extra backup tapes for litigation—a sum that doesn't include either the cost of storage or administrative hassle.

Gathering the material is only the initial expenditure. The real money starts to pile up when lawyers have to review the tidal wave of data created by the Information Age. The overall bill is often so expensive, says New York attorney Adam Cohen, that he has "settled cases with no merit solely because of the costs of e-discovery." That's an increasingly common complaint among corporate litigators. So far they're winning their quiet war for e-discovery reform. But this fight still has a few more rounds. ■

—By Mike France in New York



Telecom's New Tag Team

Intel and AT&T's alliance for new chips could shake up the communications biz

INTEL AND AT&T: THE TWO icons of American business are both a bit down on their luck these days. In the past five years AT&T has plunged from its perch as one of the world's most powerful communications companies to a shrinking player whose survival as an independent company is in question. Unable to defend its long-distance business from local phone, cable-TV, and cellular competitors, it has seen its market cap plunge from \$174 billion in 1999 to \$15 billion now.

While Intel Corp.'s problems are much less severe, it too has struggled. The Santa Clara (Calif.) chipmaker remains the dominant supplier of microprocessors, but its efforts to expand into

new markets, particularly communications, have been mixed.

Now *BusinessWeek* has learned that this unlikely pair is working together in an effort to ring up better results. The companies are cooperating on a new generation of chips that will combine the computing power of Intel with the communications expertise of AT&T. The goal is to make it easier and cheaper for customers to get everything from basic phone service and wireless broadband to HDTV-quality videoconferences and hackproof e-mail. By putting the capabilities to help deliver all those services onto chips, AT&T and Intel believe they can fundamentally change the field of communications. "This is [a] disruptive partnership that will shake the industry

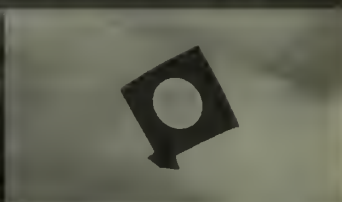


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for 10 to 20 years," says AT&T Chief Technology Officer Hossein Eslambolchi.

For starters, AT&T is helping Intel with the development of a wireless broadband technology called WiMax. The technology, which Intel will include in a line of chips dubbed Roseville beginning next year, lets computer users tap into high-speed Net connections from as far away as 30 miles from a WiMax tower. AT&T is contributing antenna expertise that promises to improve WiMax's performance, both in terms of the distances it can span and the speeds at which it can transmit. The benefit for AT&T? It will be able to sell WiMax and use the technology to offer other services like Internet calling and network security.

SHARED VISION

WIMAX IS JUST the beginning. The companies also are working on chips to power a new class of products that AT&T plans to sell as an "office in a box." Expected to hit the market in 2006, these all-in-one networking devices will direct Web traffic, maintain firewalls against viruses, provide videoconferencing, and give telecommuters nearly unhackable access to their office e-mail, Eslambolchi says. These products are expected to cost a few hundred dollars, insiders say, compared with more than \$1,500 to buy the collection of needed gear today. What's more, these devices will be able to handle telephone service that runs on Internet technology. That means a 10-person outfit that now spends roughly \$300 a month for traditional phone lines could slash costs by switching to a Net calling service like AT&T's CallVantage. "[This partnership] is an important step for us," says Sean M. Maloney, general manager for Intel's Communications Group. "We share a very similar vision for how the

world moves from the old-fashioned [telephone] network to an intelligent network to last for the next 30 years."

While the alliance has loads of potential, the companies have everything to prove. The new chips remain in the lab, and AT&T and Intel still need to persuade hardware manufacturers, such as PC makers and networking giant Cisco Systems Inc., to make products based on those chips. Meanwhile, rivals are racing ahead with competing technologies that will deliver many of the same services. Verizon Communications Inc., for example, is investing billions to string fiber optic lines to homes throughout its territory, with plans to deliver Net connections of up to 100 megabits per second. WiMax service, in contrast, likely will max out at 18 megabits per second.

The AT&T-Intel alliance began last year. Eslambolchi first approached Intel after word got back to him that the companies were working on many of the same things—especially WiMax, computer security, and Net phoning. He found that Maloney was in favor of closer cooperation and this summer the companies signed an agreement specifying projects on which they would cooperate. AT&T CEO David W. Dorman and Intel CEO-designate Paul S. Otellini have met in person twice to discuss the joint effort, including a sit-down two weeks ago.



ESLAMBOLCHI
AT&T made the first move

"Lots of times it seems we're finishing each other's sentences," says Dorman.

Much is at stake for both companies. AT&T's market cap has plunged in years as revenues and profits have ebbed. That has fueled speculation it will be acquired—BellSouth Corp. even negotiated, off and on, to buy Bell. But Eslambolchi hopes to rebuild AT&T's fortunes by cranking up services. Web services. After spending billions to upgrade its network, AT&T boasts state-of-the-art technology. While most

networks treat all traffic the same, AT&T's can identify each bit and address it to make sure it gets the right treatment. The result is that AT&T's Internet voice service works 99.991% of the time—a tad better than its century-old traditional phone work. "It's the reason for where other [phone companies] are today," says Michael V. Howard, Infonetics Research.

For Intel the joint effort could help with much-needed diversification. The company has made public pronouncements about expanding beyond microprocessors, particularly into communications, but it has struggled to do so. With AT&T contributing its technical expertise and backing that up with its marketing clout, Intel could see customers scrambling to buy laptops and desktops equipped with WiMax and other features. Separately, Intel has agreed to invest an undisclosed sum in Clearwire Inc., wireless pioneer Craig McCaw's company, which is building a nationwide WiMax network, though none of the companies has provided specifics of how they'll work together. The most likely scenario is that McCaw will build the WiMax network, and AT&T will use his network to market its own services.

While the AT&T-Intel alliance is more promise than reality at this point, both sides are optimistic. "It turns out we've got a very similar view of how Internet infrastructure will be rolled out over the next three to five years," says Intel's Maloney. They're right, the two companies may be able to show that their efforts in communications are more than just talk. ■

—By Peter Burrows in San Mateo, Calif.

Ma Bell Meets the King of Chips

AT&T and Intel are cooperating on a new generation of semiconductors that combine Intel's computing capabilities with AT&T's communications expertise. Here's what the effort could mean:

BETTER BROADBAND: AT&T is helping Intel develop chips for WiMax, which enables computer users to make wireless broadband links up to 30 miles. That will give buyers the option of WiMax service or broadband from cable or phone companies.

CHEAPER VOICE SERVICES: With the AT&T-Intel chips, computers will be able to handle voice calls that travel over the Net with the reliability of traditional AT&T service. That means much lower phone bills, plus potential extras such as videoconferencing and CD-quality sound.

SMOOTHER SECURITY: Today computer security largely depends on the software inside PCs that must be continually updated with security patches. Devices with the new chips could be protected by AT&T technology that blocks viruses before they reach PCs.

BusinessWeek online For a Q&A with AT&T's Eslambolchi, go to businessweek.com/ext



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BY CATHERINE ARNST

INNOVATIONS

Rude Rumbblings, Weighty Matters

>> Should we start worrying about "the Big One?" Two scientists at the University of California at Berkeley have detected deep tremors along the San Andreas Fault in Central California that may be harbingers of a large quake. The tremors are near the epicenter of the huge Fort Tejon earthquake of 1857, one of the biggest ever recorded in the U.S. The researchers report in the Dec. 10 *Science* that 110 tremors were measured over three years ending in December, 2003.



>> But try not to lose sleep over earthquakes—you could end up obese. Two studies released on Dec. 6 found that lack of sleep alters the levels of two appetite-regulating hormones. The result: an increase in hunger and a craving for high-carb foods. A study in the *Public Library of Science Medicine* examined the sleep of 1,024 volunteers. Compared with eight-hour-a-night sleepers, participants who slept only five hours had a 14.9% increase in ghrelin, which triggers hunger, and a 15.5% drop in leptin, which suppresses appetite. A separate report in the *Annals of Internal Medicine* found that 12 volunteers who slept four hours a night for two nights had a 28% hike in ghrelin and an 18% drop in leptin.



AGRICULTURE

BIOTECH CROPS PUT DOWN GLOBAL ROOTS

GENETICALLY ENGINEERED crops may be controversial, but they're well entrenched around the world. Only eight years after the first biotech crops were commercialized, they are now grown in 18 countries and are the target of research in an additional 45, according to a new report. Titled "The Global Diffusion of Plant Biotechnology," the report was funded by the industry group Council for Biotechnology Information.

Worldwide, biotech crops

are now worth about \$44 billion a year. While the U.S. accounts for half of the total, the fastest growing adopters are developing nations. China, for example, is second only to the U.S. in supporting biotech crop research.

In addition to popular target crops maize, cotton, soybeans, and canola, some 57 other engineered crops are under development. Asia, Latin America, and parts of Africa are expected to increase plantings in coming years.

DRUG RESEARCH

AFTER 40 YEARS, A POTENT TB DRUG

TUBERCULOSIS KILLS 2 million people each year, and every year about 300,000 cases are found to be resistant to the antibiotics used in treatment. Yet there has not been a new TB drug in over 40 years.

Scientists at Johnson & Johnson hope to end that drought with a novel antibiotic that blocks the energy source of the bacterium. When tested on TB-infected mice, the drug, called R207910, worked better and faster than existing

treatments. It also proved safe for healthy humans in early clinical trials. Currently, TB is treated with a cocktail of three antibiotics that must be taken for six to nine months. The research team, reporting on Dec. 9 in the online version of *Science*, said that in tests on mice the new drug cut treatment time in half when added to the cocktail. After two months on the drug, no TB bugs could be detected in the lungs, a finding the team called "unprecedented." It was also effective against all multidrug-resistant strains of TB tested.

MEDICINE

THE CORRECT ANSWER TO SPINAL JEOPARDY?

RESEARCHERS at Purdue University have devised an unusual method for healing spinal injuries in dogs and enabling them to walk again, a development that raises hope that the same technique might be adapted for human use. The key is polyethylene glycol (PEG), a liquid polymer similar to antifreeze.

Working with injured dogs brought to two veterinary hospitals by their owners, the researchers injected 19 paraplegic animals with PEG within 72 hours of injury. The dogs also received the standard treatment of steroids, surgery, and physical rehabilitation. They were compared with 24 dogs that received only standard therapy. The researchers reported in the December issue of the *Journal of Neurotrauma* that more than half the dogs in the PEG group walked within two weeks of treatment, and 13 were able to walk within 8 weeks. Only 25% of the dogs in the control group ever reached the same level of mobility.

Dr. Richard B. Borgens, director of Purdue's Center for Paralysis Research, says PEG works by fusing cell membranes together. In the future, he would like to test the compound on injured humans.



WALKING
A PEG
patient

WHEN FORMER COCA-COLA CO. executive E. Neville Isdell agreed last May to come out of retirement and become chief executive of the beleaguered soda giant, he brimmed with confidence. No Coke newcomer, Isdell had spent 35 years inside the vast Coke system as the Atlanta company built itself into the world's most recognized global brand, retiring in 2001 after a three-year stint as head of a large European Coke bottler. "The system isn't broken," Isdell told a *BusinessWeek* reporter at the time. "There's still opportunity for both Coca-Cola and the other brands."

All it took was a tour of Coke's operations in India, China, and 14 other key markets this summer for Isdell to see a different reality: Coca-Cola was a troubled company. Things looked so bad that just 100 days into his new job the 61-year-old Irishman interrupted his fact-finding mission to deliver a surprise warning to Wall Street. Coke, which had been struggling since the death in 1997 of its revered CEO, Roberto C. Goizueta, had made little progress in its efforts to meet the rising challenges of noncarbonated drinks. The soda giant would fall short of the meager 3% growth in earnings that analysts were resigned to for the third and fourth quarters. Moreover, Isdell was clearly prepping Wall Street for perhaps another year—or longer—of underperformance. "We've got a long way to go," a chastened Isdell told analysts. "The last time I checked, there was no sil-

ver bullet. That's not the way this business works." Coke later announced that third-quarter earnings had fallen 24%, the worst quarterly drop at Coke in recent history.

As late as the 1990s, Coca-Cola Co. was one of the most respected companies in America, a master of brand-building and management in the dawning global era. Now the Coke machine is badly out of order. The spectacle of Coke's struggles has become almost painful to watch: the battles with its own bottlers; the aged, overbearing board; the failed CEOs and failed attempts to recruit a successor; the dearth of new products; the lackluster marketing. "They've been their own worst enemy, casualty of their own success," says Emanuel Goldman, who has followed Coke as an analyst since the 1970s.

Yet as grave as those problems are, they only hint at the real dimensions of Coke's woes. The Coca-Cola organization is stuck in a mind-set formed during its heyday in the 1980s and '90s, when Goizueta made Coke into a growth story that captivated the world. An unwillingness to tamper with the structure and beliefs formed during those glory years has left the company unable to adapt to consumer demands for new kinds of beverages, from New Age teas to gourmet coffees, that have eaten into the cola king's market share. "The whole Coke model needs to be rethought," says Tom Pirko, president of BevMar LLC, a Santa Barbara (Calif.) consulting firm. "The carbonated soft-drink model is 30 years old and out of date."

Of all the problems that can beset a corporation, a dysfunctional culture has to be one of the toughest to fix. How do you



Gone

t thousands of employees suddenly to change their most basic assumptions about their company? After all, the beliefs and attitudes that make up a culture filter into everything else: decisions on basic strategy, management style, staffing, performance expectations, product development. That's why the problems at Coke have proven so intractable. A succession of managers has focused on trying to do what Coke has always done, only better. Meanwhile, rival PepsiCo Inc. has a much different view of its mission (hint: it's not just about soda pop)—one that has helped it adapt far more successfully to a changing marketplace. Until Coke can lay the ghost of Goizueta to rest and let go of some long-cherished beliefs, it's unlikely to fix problems.

Frozen in Time

THE LATEST COKE CEO capable of leading Coke out of the valley? It's too early in Isdell's tenure to say for sure, but the early signs are not promising. Although he earned a reputation for bold decision-making as a young executive, Isdell seems to have fallen into lockstep with the reigning Coke orthodoxy. He says the company's salvation lies in simply tuning up the soda operations and capitalizing on existing brands. "We are not talking about radical change in strategy," he told Wall Street analysts in November. "We are talking about a dramatic change in execution."

That was more or less the playbook used by Roberto Goizueta,

a charismatic CEO. The Cuban-born executive sold off ancillary businesses and refocused the company on what it did best: selling carbonated soft drinks. At the same time he engaged in some sophisticated reengineering of the company's financial structures. In 1986, Coke spun off a 51% stake in its U.S. bottling operations, a shrewd bit of financial alchemy that let it dump billions of dollars of bottling-related debt off its balance sheet while allowing it to continue pulling the strings at the spin-off. Thanks to near-constant buying and selling of small bottling operations, the deal also helped Coke achieve consistent profit gains, turning the once-stodgy company into—shazam!—a growth stock.

Meanwhile, Coke was able to ride the global boom like few other companies, rushing into once-closed economies such as China, East Germany, and the Soviet Union and sating their pent-up demand for a taste of America. The result: Coke stock soared 3,500% during Goizueta's 16-year reign, helping to make him one of the first supercompensated CEOs and the first professional manager to break the \$1 billion pay barrier. After his death from lung cancer in October, 1997, Goizueta was all but deified, his financial structures, his cola-centric philosophy, and even his board of directors frozen in place ever since.

The ensuing years have seen a long and painful descent. After generating average annual earnings growth of 18% between 1990 and 1997, Coke's net income in recent years has grown an average of just 4%. Shares have fallen hard, currently trading at less than half their 1998 peak as more and more investors con-

The good old days weren't as good as you thought. That's one more reason Coke's latest CEO needs a bold new formula

BY DEAN FOUST



clude that Coke's best days may be behind it. "At Coke," says Brian Holland, research director at Boyd Watterson Asset Management LLC, a Cleveland money manager that has cut its Coke holdings by 84% since last December, "there's a lot to fix, and there's no short-term solution."

In the absence of a clear vision, Coke's desire to cling to its past is not hard to understand. After all, in Coke Classic, the company is blessed with a flagship product that remains, for all of the management missteps of the past decade, one of the most powerful brands in the world. And despite the company's problems, it is still a cash cow. Helped by the dollar's decline against other major currencies, Coke is expected to generate roughly \$5 billion in operating profits this year, far beyond such companies as Nike, Colgate-Palmolive, and McDonald's that have similar global ambitions. Indeed, part of Coke's paralysis is a fear that nothing else the company enters will ever match the extraordinary margins of soda concentrate.

"Smoke and Mirrors"

GOIZUETA'S MOST INGENUOUS contribution to Coke, the ingredient that added rocket fuel to the stock price, was a bit of creative though perfectly legal balance-sheet rejiggering that in some ways prefigured the Enron Corp. machinations. Known inside the company as the "49% solution," it was the brainchild of then-Chief Financial Officer M. Douglas Ivester. It worked like this: Coke spun off its U.S. bottling operations in late 1986 into a new company known as Coca-Cola Enterprises Inc., retaining a 49% stake for itself. That was enough to exert de facto control but a hair below the 50% threshold that requires companies to consolidate results of subsidiaries in their financials. At a stroke, Coke erased \$2.4 billion of debt from its balance sheet. Just as important, it was able to command six board seats at CCE, which it packed with current or former Coke executives, including then-Coke President Donald R. Keough. With effective control,

Coke for years could ensure that CCE was run to Coke's benefit. "Coke was creating a special-purpose entity, like Chewbacca from Enron," marvels one Wall Street analyst, referring to Enron's Chewco Investments limited partnership. Coke disputes any comparison to Enron and says the spin-off was simply a way

-26%

Total return to **Coke** shareholders since the death of Roberto Goizueta

46%

Total return to **Pepsi** shareholders in the same time period

Data: Standard & Poor's

"to leverage substantial efficiencies and adapt more rapidly to the changing trade landscape in the U.S."

Its behind-the-scenes control of CCE allowed Coke to extract a series of advantages, from pricing to deciding how many vending machines CCE purchased. Coke had tacit control over how much its largest customer—CCE—paid for the concentrate Coke sold it, as well as how much CCE charged retailers for the actual soda. Thus the esca-

lating price wars between Coke and Pepsi came much more out of CCE's margins than Coke's, especially since Coke also required CCE to shoulder a growing portion of its brands' marketing costs.

But that was just one aspect of this unusual relationship. In the '80s and '90s a generation that ran small, family-owned bottlers was looking to retire. Coke had been snapping up these operations as a way to assure quality and to keep them from falling into the hands of leveraged-buyout artists, who would likely bleed them for their cash flow. In CCE it had another so-called anchor bottler, one of roughly a dozen around the world, from which it could exact ever-higher profits as it resold these smaller bottlers to the anchors. There were so many such deals that Coke was able to convince analysts the resulting profits should be considered part of normal operations and not extraordinary income.

For a time, this flurry of dealmaking masked the problems building in Coke's international business. But by the end of the '90s, Coke simply ran out of assets to resell, and its largest bottlers began to sink fast under all the debt-financed acquisitions they had made at Coke's behest. The result: Coke's profits stalled, with operating income falling from \$5 billion in 1997 to as low as \$3.69 billion in 2000. "In hindsight, a lot of what Coke was doing was smoke and mirrors, stuff that wouldn't pass the accounting standards of today," notes Douglas C. Lane, a private fund manager who now holds 400,000 Coke shares. "And at the time it created expectations of growth that weren't real." Coke notes that all such transactions were fully disclosed at the time.

The next move was inevitable: Coke imposed a crushing 7.6% price hike on its bottlers in the late '90s as Ivester, now CEO, desperately tried to sustain Goizueta's profit streak. Coke's U.S. bottlers, livid over the price increase, burned up the phone lines to some key Coke board members and succeeded in pushing the already embattled Ivester over the ledge. In late 1999, he resigned.

Ivester's successor, Douglas N. Daft, tried to work with bottlers, but relations have steadily deteriorated since. (Daft served on the board of The McGraw-Hill Cos., which publishes *BusinessWeek*.) In a sign of disunity that would have been unthinkable in the Goizueta era, some bottlers are beginning to push back with price hikes that could boost their own profits—Coke's expense.

SEEING RED

Contracts with German bottlers like this one will be rebid in 2007



**Break
Down**

Coke today struggles to do things that once made it great



BUNDLING MARKETING

world-class, say that the soda giant has come too expensive, with its Rockwell-like ads that don't resonate with teenagers and adults that make it the most important piece.

FRICTION WITH BOTTLERS

Over the past decade Coke has often made its profit at the expense of bottlers, pushing aggressive price hikes on the concentrate it sells them. But key bottlers are now fighting back with sharp increases in the price of Coke at retail.

MEDDLING BOARD

Coke's star-studded group of directors, many of whom date back to the Goizueta era, has built a reputation for meddling: Some insiders believe the last CEO, Doug Daft, never recovered after the board unexpectedly vetoed his 2000 deal for Quaker Oats.

LACK OF INNOVATION

In the U.S. market, Coke hasn't created a best-selling new soda since **Diet Coke** in 1982. In recent years, Coke has been outbid by rival PepsiCo for faster growing noncarb beverages like SoBe and Gatorade.



INTERNATIONAL WORRIES

Coke desperately needs more international growth to offset its flagging U.S. business, but while some markets like Japan remain lucrative, in the large German market Coke's had so many problems it's rebidding all bottling contracts in 2007.

While those hikes could dampen sales—and thus reduce the amount of concentrate bottlers need to purchase from Coke—the bottlers are clearly banking on the belief that they will come out ahead, even if Coke doesn't. At the same time, many bottlers have refused to carry some of the company's new noncarbonated niche offerings that Coke acquired, such as Mad River teas and Planet Java coffee, forcing the company to bury both products last year. While CCE executives maintain that relations have improved under Isdell, Trevor Messinger, a Coke bottler in

Rapid City, S.D., readily admits relations between Coke and some bottlers are contentious. "I don't think everybody is on the same page of the playbook," he says.

If the friction between Coke and its bottlers worsens, some analysts believe that Isdell will have no choice but to resort to radical measures to defend Coke's interests—such as reacquiring the 62% of CCE it doesn't own. (Coke's stake has declined to 38% because of dilution.) If CCE continues to raise prices, then reabsorbing the bottler could be the only means left for Coke to

ensure that it maintains its share of the pie, reasons Morgan Stanley analyst William P. Pecoriello.

Another scenario swirling inside the Coke system would have Isdell reacquiring CCE and then breaking up its assets and territories for resale to smaller bottlers or even major U.S. beer distributors—which as private companies may be content to work on lower margins than publicly traded CCE. But for now, Coke shows little willingness to tamper with this vestige of the Goizueta era. “I think that there are a number of things that we can do together without having to consider changing the model,” Isdell said in an interview.

Nowhere is the Goizueta orthodoxy more apparent than in the company’s unwavering focus on its aging group of soda-pop brands, especially the hallowed four: Coca-Cola, Diet Coke, Sprite, and Fanta. Goizueta was fond of discussing Coke’s market share in terms of “share of stomach,” as though, with the right marketing, people could be induced to give up coffee, milk, and even water in favor of Coke. Seven years after his death, the company remains fixated on making its flagship Coke brand the universal beverage from Stockholm to Sydney. Coke’s sodas constitute 82% of its worldwide beverage sales, far more than at Pepsi, which is gaining on Coke’s lead in the U.S. beverage market and numbers Tropicana juice, Gatorade sports drinks, and Aquafina water among its billion-dollar beverage brands.

Coke loyalists still believe in the the mantra first coined by legendary Coke Chairman Robert W. Woodruff and often repeated by Goizueta, of putting a Coke within an “arm’s reach of desire” of consumers around the globe.

But increasingly, consumers are reaching for anything but a soda.

The mass market that Coke was so adept at exploiting has splintered. Consumer tastes have shifted from sodas to an array of sports drinks, vitamin-fortified waters, energy drinks, herbal teas, coffee, and other noncarbonated products, some of which are growing as much as nine times faster than cola. After rising steadily during the ’80s and ’90s, per capita soda consumption in the U.S. has declined every year since 1998. Yet when Daft tried to push Coke to become a “total

beverage company,” he met with resistance from Coke’s board.

In an interview early in the Daft years, investment bank and director Herbert A. Allen dismissed Daft’s efforts, declaring: “That’s all fine and good, but I still believe that getting the four core [soda] brands right is 85% of the equation.” That attitude still seems to dominate. One director, speaking on the condition he not be named, recently dismissed bottled water “something I guess we have to carry. But the fact is we’re still the kings of carbonation—always have been, always will be.”

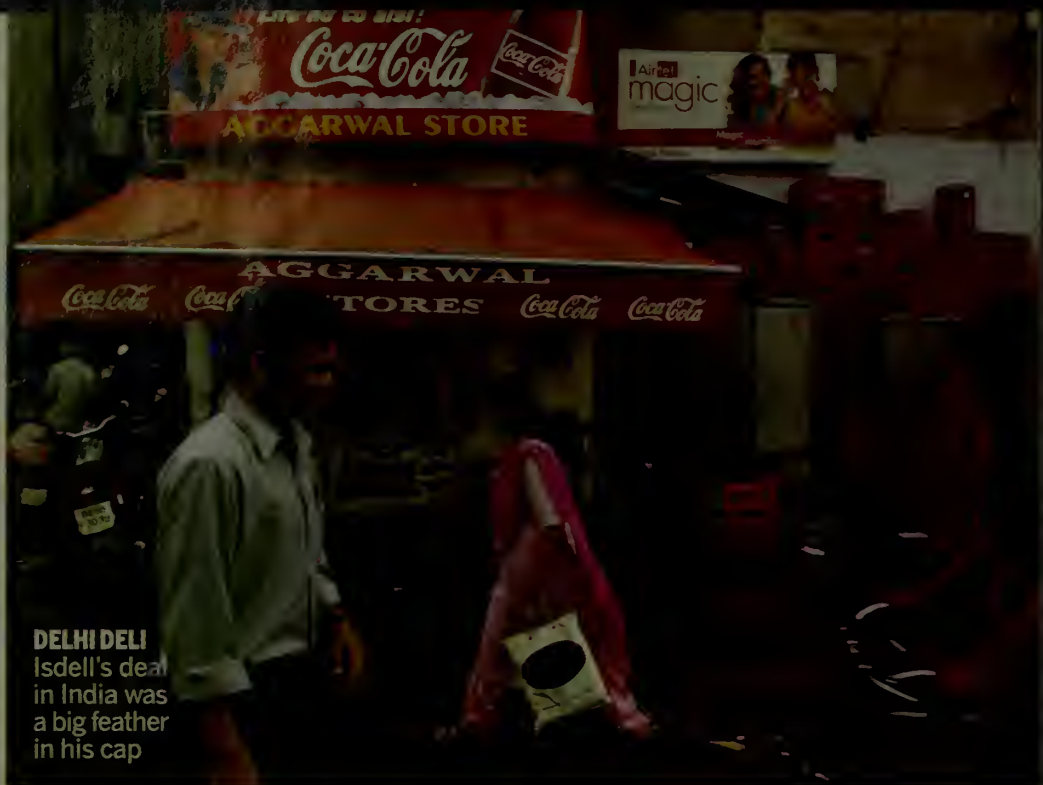
Coke’s cultural resistance to diversification has become an enormous liability. South Beach Beverage Co., for example, negotiated with Coke for two years before the soda giant decided against acquiring the New Age juice company. It took Pepsi just two weeks to make an offer. Is SoBe a huge brand? No, but it gives Pepsi access and insight into a market that its soda pop completely bypasses. If you think of yourself as a beverage-and-snack company, as Pepsi does, that’s valuable. If you think of yourself as a soda company, as Coke does, it’s not.

Pepsi Generation

ITS PORTFOLIO OF BEVERAGES and its faster-growing snack foods give Pepsi enormous clout with retailers. Pepsi boasts that it has become the second-largest generator of revenues, after Kraft Foods Inc., for its largest grocer customers. Pepsi isn’t satisfied about using that clout to try to wrest shelf space from Coke and other rivals. “If we were only playing in carbonated soft drinks competitively we would be disadvantaged in many ways,” says PepsiCo CEO Steven S. Reinemund. “Being outside carbonated [soft drinks] makes sure we’re growing in the areas where there is growth.”

Isdell has said he’ll explore new beverage categories. If so, he’ll be starting well behind Pepsi. Pepsi got a two-year jump on Coke in bottled water and later outmaneuvered Big Red to acquire both SoBe and Gatorade. As a result, Coke’s Powerade has just a 17% share of the fast-growing sports-drink segment in the U.S., vs. 81% for PepsiCo’s Gatorade brand. And after garnering just a 2.8% share of the popular energy-drink category vs. 58.5% for independent rival Red Bull—Coke plans to t

DELHI DELI
Isdell's deal in India was a big feather in his cap



82%

of **Coke's** global volume is carbonated soft drinks

65%

of **Pepsi's** North American beverage volume is carbonated soft drinks

gain with a second energy drink, Full Throttle, in January.

But in reaching into new categories, Coke may have to figure out how to get these beverages to market using food brokers, since its dedicated bottlers have been loath to handle new products that don't approach the high volumes of soda. Here, too, Pepsi has a head start. Gatorade is already distributed through a well-established system of brokers. Coke also may have to reduce its profit expectations, since the margins on noncarbonated drinks are generally lower. "Even with premium price, they cannot achieve those [soda] margins in the New Age category," warns Lance Collins, founder of New Jersey-based Fuze Beverage LLC, whose products include a diet pomegranate white tea.

The one area at Coke where the thinking has changed since the height of the Goizueta era, though not necessarily for the better, is marketing. At his Atlanta funeral, Goizueta was eulogized to the strains of *I'd Like To Teach the World To Sing* from Coke's syrupy but unforgettable commercials of the '70s. At the height of its powers, the Coke marketing machine could turn even disaster into triumph, as it did when Coke tampered with its historic concentrate formula in 1985. The sweeter new concoction backfired, but Coke seized the opportunity to build intense loyalty for Coca-Cola Classic.

The marketing magic at Coke had begun to fade even before Goizueta's death. In the late '90s, Ivester began shifting resources away from advertising and into blanketing the world with as many vending machines, refrigerated coolers, and delivery trucks as Coke and its bottlers could muster. The goal was simple ubiquity, while the niceties of brand-building were ignored. "There was no vision, no marketing," recalls one former executive. "It was all growth through distribution."

This proved to be a costly shift. For one, vending machines that were put into unconventional locations such as auto-parts stores didn't always pay off. Coke's lackluster advertising didn't help, either. Ivester, who had a deep distrust of Madison Avenue, tended to starve the ad budget, believing that the iconic Coke brand was powerful enough to sell itself. That began to change under Daft, who hired Steven J. Heyer, a former ad exec, and promoted him to president. Then, to evade the stifling Atlanta bureaucracy, he and Heyer pushed decision-making out into the field. But the move went wrong when Coke's local marketers, suddenly unshackled, began producing racy ads, including an Italian spot featuring a couple skinny-dipping. That prompted Coke headquarters to reclaim control and revert to bland Norman Rockwell-type ads. The result, says one former marketing executive, is an erosion of Coke's perceived value as a brand: Starbucks can charge \$2 for a cup of coffee, and they can barely sell a 12-pack of Cokes for \$2."

In recent years, Coke showed signs of regaining its footing on the marketing

front, thanks in large part to Heyer. But Heyer's departure in June after he was passed over for the top job was viewed as a big loss and is likely to lead to an exodus of the talent he brought to Coke during his three-year tenure. His successor, longtime Coke exec Charles B. "Chuck" Fruit, contends that Coke is producing good ads but has been hurt by a propensity to careen from campaign to campaign. "We've suffered from an impatience that we're going to have to overcome," he says. "When we change campaigns and have 11 different looks to a brand at any one time, we're swimming upstream."

"Simple Little Things"

TO REALLY BREAK OUT, Coke could make a transformative acquisition, as Pepsi did in the 1970s when it bought Frito-Lay Inc. But Isdell is downplaying the notion of a big, audacious fix for Coke's troubles. In fact, he readily admits that during one of his European tours he passed on the chance to acquire Red Bull—the independently owned, market-leading energy drink. Rather than a gaudy acquisition, Isdell maintains that Coke's redemption will come from its ability to better perform the "millions of simple little things" that Coke employees do around the globe each day. And Isdell is adamant that there's still growth in carbonated soft drinks. The reason goes back to the bottom line: He says there just aren't many businesses for sale that produce the lush margins—around 30%, some analysts estimate—that Coke makes from selling its proprietary



Following a Legend

It hasn't been easy to fill Goizueta's shoes. The first two tried to adhere to his philosophy—under the gaze of an intrusive board. Will Isdell veer from the script?



M. DOUGLAS IVESTER

Goizueta's successor and a financial whiz, he didn't spend on advertising and angered bottlers

DOUGLAS N. DAFT

After Ivester, this former Asia chief chopped headquarters staff, leading to low morale

E. NEVILLE ISDELL

Despite his reputation as a maverick, the longtime exec has so far eschewed radical fixes

concentrate to bottlers. In the end, Isdell has come around to the view that there's plenty of growth left in soda pop. "Regardless of what the skeptics may think, I know that carbonated soft drinks can grow," he told analysts in mid-September.

That's a remarkably conservative strategy for a man who made his name as a change agent at the soda giant. During his years of helping Coke crack emerging markets in Africa, Asia, and Eastern Europe—assignments that earned him the reputation as the "Indiana Jones of Coke"—the gregarious former rugby player made his mark as the revolutionary who was always willing to challenge the corporate dogma. As a European executive in the late 1980s, Isdell pushed the company into bottled water—a full decade before the cola-centric managers did the same back in the U.S. "He got an awful lot of grief from headquarters," recalls Gavin Darby, a former Coke executive.

And when Coke was poised to reenter India in 1993 after a 17-year absence, Isdell allowed his local managers to establish a beachhead by purchasing the leading India soda maker, Parle, even though Coke had long frowned on acquiring rival soda makers. Coke's former India chief, Jay Raja, recalls Isdell telling him to go for it: "We agreed that we would ask for forgiveness instead of permission." Isdell's instincts were proven right: At a later board meeting, Goizueta hailed Isdell's move, which gave Coke 60% of the Indian soda market almost overnight, as "the deal of the decade," recalls Raja.

Notorious Board

PERHAPS THE BIGGEST impediment Isdell faces, outsiders say, is Coke's board. More than anyone else, the directors, especially the powerful triumvirate of Warren E. Buffett, Herbert A. Allen, and Donald Keough, are the keepers of the flame at Coke. Over the years they have strictly enforced obedience to the Goizueta Way. This politburo of the Goizueta era (of 14 directors, 10 date back to the late CEO) has chewed through two CEOs in the past five years. Three directors are over the age of 70, but don't look for any departures soon. Earlier this year the board waived Coke's mandatory retirement age, 74, to allow Buffett to remain and Keough to rejoin.

This is a group that believes in getting involved—very involved—in company affairs. Many Coke insiders feel that Daft, Isdell's predecessor who abruptly announced his retirement last February, never recovered from Buffett's 11th-hour veto of his attempt to steal Quaker Oats Co. from Pepsi in November, 2000. The deal was quashed when the legendary financier declared at a special board meeting that Quaker and its powerful Gatorade brand weren't worth giving up 10.5% of the Coca-Cola Co. Daft

declined to speak for this article except to say he retired for health reasons. "The board has to challenge management's plan but should not challenge its authority. The Coke board was micro-managing," says John M. Nash, a board consultant and former president of the National Association of Corporate Directors.

So notorious is the Coke board that many blame it for the humiliating rejections Coke received from a string of CEO candidates the board courted before anointing Isdell. Even Buffett's prestige were not enough to persuade James M. "Jim" Kiltz, head of Gillette Co., where Buffett was director for years. Like Robert A. Eckstein of Mattel Inc. and Carlos M. Gutierrez of Kellogg Co., Kiltz passed on the opportunity to head the world's most powerful brand. (Indeed, one executive that Coke approached for the job was rankled by the way Coke's board leaked the names of people it was pursuing. "It was like the search was playing out on CNN," he says. "One of the greatest legacies that [Isdell] can leave behind is a reshaped board.")

Board members have made clear their opposition to product diversification, as well as their belief that mergers aren't what's needed. At times they've even involved themselves in operations. Keough rankled some marketing staffers when earlier this year he personally killed an edgy TV ad—in which a tee-wiper a Coke can under his armpit before handing it to an unwitting friend—that he deemed in poor taste. Isdell maintains that he'll be able to stand his ground with Coke's board. Sonya I. Soutus, a Coke spokeswoman, says it's "presumptuous and unfair" to criticize Coke's board members, who she says have substantial stockholdings, bring wealth of experience, and have taken steps to address Coke's problems.

Can Isdell return Coke to greatness? In some ways, the clock is working against him. At 61, he may be only a transitional CEO. Still, long-timers can sometimes bring special skills to rejuvenating a tired corporate culture. "As a kid, I was a product of Procter & Gamble, and William Johnson was a product of [H.J.] Heinz," notes Gary M. Stibel, a management guru at Westport (Conn.)-based New England Consulting Group. "They remembered what it was like when their companies were great, and they returned them to that greatness."

There are plenty of other examples, though, such as Eastman Kodak Co., where a succession of CEOs was unable to break from the past and continued to ride outdated models and product lines nearly into oblivion. As two CEOs have already discovered at Coke, it isn't easy following in the footsteps of a legend. ■

—With Nanette Byrnes in New York and bureau reports

Coke vs. Pepsi

Pepsi never quite caught Coke in the cola wars, but its portfolio strategy has made it the long-term winner

COKE	PEPSI
Sales \$21 BILLION	Sales \$27 BILLION
Sales Growth* 2%	Sales Growth* 4%
Earnings \$4.3 BILLION	Earnings \$3.6 BILLION
Earnings Growth* 4%	Earnings Growth* 12%
Stock** -40%	Stock** 38%
Business Breakdown 100% BEVERAGE	Business Breakdown 37% BEVERAGE
	58% FRITO-LAY SNACKS
	5% QUAKER CEREAL

Data

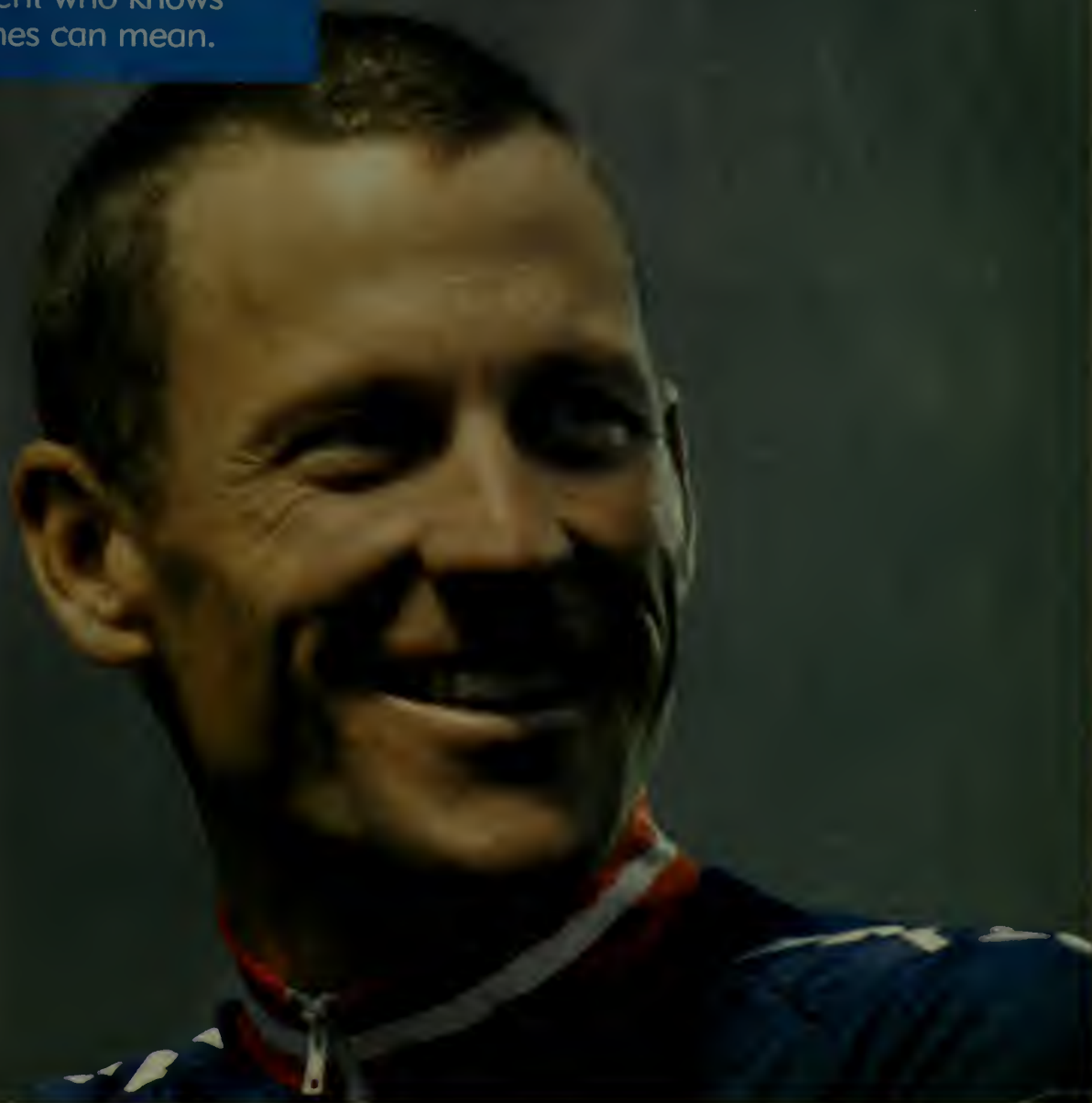
BusinessWeek online

For a Q&A with Coca-Cola CEO Neville Isdell and a Coke time line, go to www.businessweek.com/extras

Three extraordinary medicines
launched within sixteen months.

Three potential medicines
in late stage clinical trials.

And one patient who knows
what medicines can mean.



*Lance Armstrong,
cancer survivor and six-time
Tour de France winner*

It was an extraordinary year for cyclist Lance Armstrong. He won the Tour de France a historic sixth time—after coming back from cancer with the help of several Bristol-Myers Squibb medicines.

At Bristol-Myers Squibb, we, too, have met challenges that have led to successes. In the space of sixteen months, we introduced three major medicines—for cancer, HIV, and serious mental illness. These medicines are already transforming lives around the globe.

Plus, we have three promising investigational compounds—for hepatitis B, type 2 diabetes, and rheumatoid arthritis—in the final phase of clinical trials. All were discovered and developed by Bristol-Myers Squibb scientists. Close behind these three, we have six more investigational medicines in full development.

At Bristol-Myers Squibb we've never been more focused on our mission: to extend and enhance human life. Today, and tomorrow.



Bristol-Myers Squibb Company

Hope, Triumph, and the Miracle of Medicine

The Warranty Windfall

Service contracts are cash cows—but retailers are mum about their importance

HERE'S A SECRET TWO OF the nation's largest consumer-electronics chains don't want investors to know. As TVs, portable DVD players, and other stuff fly off their shelves, Best Buy Co. and Circuit City Inc. aren't banking on them to rake in the profits. Instead, they're counting on the extended warranty contracts that they sell aggressively along with the goods.

Warranties cost virtually nothing to market, and the products they insure rarely need repairs (page 86). Says FTN Midwest Securities Corp. analyst Daryl Boehringer: "It's just pure profit flowing down to the bottom line."

Last year, profits from warranties accounted for all of Circuit City's operating income and almost half of Best Buy's, say analysts. They figure that profit margins on contracts are between 50% and 60%. That's nearly 18 times the margin on the goods themselves. For example, a four-year contract on a \$3,000 flat-panel TV costs about \$400. Best Buy gives its insurers \$160 and keeps \$240 for itself.

But you won't find details of such fabulous returns in company fi-

nancial statements. "We do not share information about specific profitability of any product or service sold at Best Buy," says Best Buy spokeswoman Sue Busch Nehring in an e-mail.

Accountants say the lack of detail raises questions about the transparency of earnings. And it's certainly information investors would want to know. Stiffer competition and an accelerating fall in the prices of big-ticket electronic items threatens those profits. "With their strong dependence on service-contract

revenue, any pronounced slowdown would have a large negative impact on earnings," says Boehringer.

Indeed, Wal-Mart Stores Inc. has jumped into consumer electronics in a big way and now controls 20% of the market. Best Buy, with \$22 billion in sales in fiscal 2004, still has 31%. But Wal-Mart has passed Circuit City, which had \$9.7 billion in sales last year and a 14% share.

Unlike the many specialist chains, Wal-Mart doesn't offer extended-service contracts; its lack of salespeople makes the contracts difficult to pitch. But if Wal-Mart, tempted by the eye-popping margins, decided to roll out its own line of warranties, it would have

Guaranteed Profits

Best Buy and Circuit City depend on selling extended-service contracts along with their electronics

BEST BUY | CIRCUIT CITY

SERVICE CONTRACTS
AS A PERCENTAGE OF SALES

4% | 3.3%

AS A PERCENTAGE
OF OPERATING PROFITS

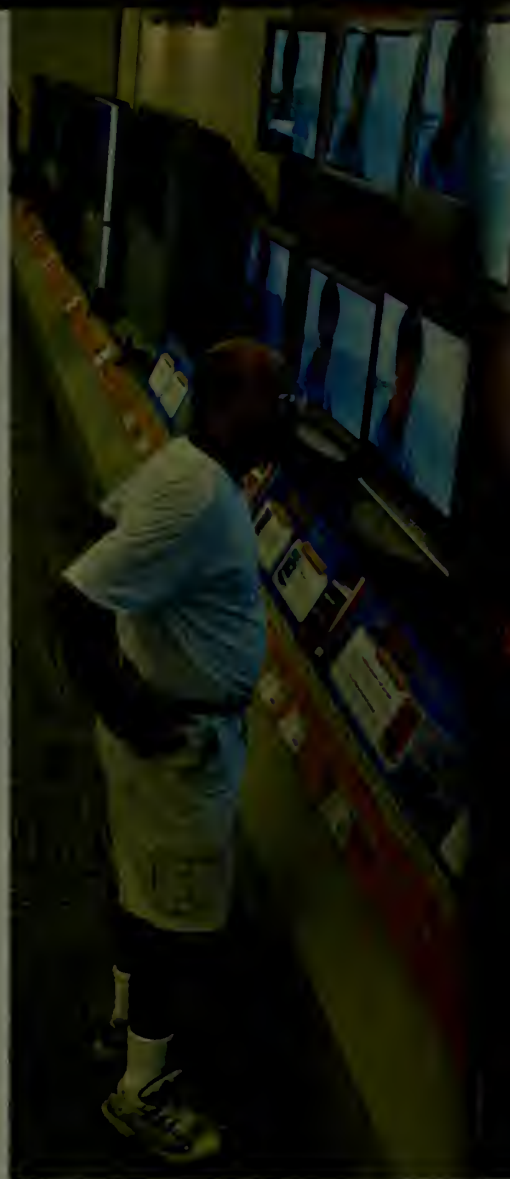
45% | 100%

PROFIT MARGINS ON CONTRACTS

60% | 50%+

Figures are for year through February 2004

Data: Company reports, Midwest Research, industry sources



room to be even more cutthroat on electronics prices, and could conceivably undercut rivals on the warranty prices, too. Jim Sebastian, of SAFE LLC, a warranty consultancy, says he believes that Wal-Mart has tested contracts. Wal-Mart didn't return calls seeking comment.

GUESSING GAME

AS SERVICE CONTRACTS become more critical to its bottom line, Best Buy has actually cut back on disclosure. The Richfield (Minn.)-based chain doesn't report its warranty profits separately, though it used to give the percentage of sales that the contracts comprised. It stopped doing that after fiscal 2001 and buried the number in a revenue category labeled "other." Then for fiscal 2004 it stopped reporting the "other" category altogether.

Circuit City is more forthcoming. The Richmond (Va.)-based outfit reports how much revenue the contracts generate along with the percentage of sales they make up—but not the profit they produce. For the year ended Feb. 29, it said its war-



BIG PICTURE
A Richmond (Va.) shopper checks out plasma TVs

Paul R. Brown, an accounting professor at New York University's Stern School of Business. What's more, generally

accepted accounting principles, or GAAP, call for the release of any facts that are material to a business and significant enough to influence investors. The trend at Best Buy toward providing less information, Mulford says, "flies in the face of this new world calling for more transparency in accounting."

EARLY ADOPTERS

BOTH BEST BUY and Circuit City got serious about the warranty business in the mid-1990s. To jump-start contract sales, which then totaled less than 1% of revenue, Best Buy started pushing its employees to sell the contracts much harder. And it turned to insurance giant American International Group Inc. to underwrite the plans so it wouldn't have to insure the products itself. Circuit City, meanwhile, turned to insurer AON Corp. for much of its underwriting as it expanded its warranty sales.

For Best Buy, the strategic shift could not have been better timed. In the fourth quarter of fiscal 1996—when it disclosed that the contracts enjoyed higher margins than the products being insured—Best Buy's operating profit fell 19%, owing to weak Christmas sales. Had it not enlisted AIG, its earnings would have been hit even harder. With AIG now carrying the

risk of payments to repair or replace goods, Best Buy could book all the warranty revenue at the time of sale, instead of amortizing it over the life of the multiyear service contract.

At first, Best Buy was a little too aggressive in how it booked the new warranty revenue that streamed in. At the end of 1999, the Securities & Exchange Commission required Best Buy to restate earnings back through

fiscal 1996, when it had turned to AIG. The problem? Even though Best Buy no longer carries the risk on the contracts, the chain is still held responsible for it under the laws of a handful of states where it has stores. So Best Buy had to readjust its results by amortizing contract revenue from those states, shaving a combined \$49 million off operating profit for those four years, or 7%.

Now, there's reason for investors to be worried that the gusher of warranty rev-

ty revenue totaled \$326 million, or 1% of sales. Clearly, says SAFE's Sebastian, the retailers "don't want to disclose to the Q. Public how much money they are making on these contracts."

Using details gleaned from industry sources, though, analyst Boehringer put together estimates of just how lucrative these contracts are. For the year ended Feb. 28, he estimates contract profits accounted for 45%, or \$600 million, of Best Buy's \$1.3 billion operating profit. He figures that without contract profits, Circuit City would have posted an operating loss from continuing operations of \$95 million last year instead of a \$64,000 profit.

Neither Best Buy or Circuit City will discuss why they don't disclose more about their warranty business. Best Buy's Bohring says the products and the contracts should be seen as inseparable. Circuit City spokesman William Cimino says the retailer stands by its financial reporting and adds: "We feel we give an appropriate amount of information."

Critics say the companies are taking advantage of a gray area of accounting that involves judgment calls. Charles Mulford, a Georgia Institute of Technology accounting professor and expert on financial transparency, says the companies could make a case that product and contract sales are so intertwined that they don't need to be reported separately. But he contends that the companies should treat warranty sales as a separate business and break out its revenues and profits.

Under guidelines from the rulemaking Financial Accounting Standards Board, the contracts meet one important test for separate treatment: They provide more than 10% of operating profits. The contracts also meet another FASB test because company execs clearly treat warranty sales separately when they discuss how to boost that business, says

Plunging prices for big-ticket items could end the easy money

venues might slow. Contracts on expensive digital TVs with liquid-crystal displays, plus plasma TVs, account for well over half of such income at both retailers, analysts figure. But deflation on high-priced electronics is accelerating: Prices now fall by 4.5% every 18 months, nearly twice the rate of five years ago. As prices decline, consumers become less willing to buy the

service plans, figuring that if their gadget breaks, they'll just buy a new one. The trend led to a fall last year in Circuit City's contract revenues to 3.3% of sales, from 3.6% the year before. So the company got employees to focus more intently on selling contracts, a campaign that paid off in the latest quarter, when the figure kicked up to 4.1%.

Deflation isn't the only negative for investors. The retailers are in a sweet spot now as consumers switch from analog to digital TVs, but that transition will wind down in the next couple of years, analysts say. Soon investors may be wishing they could buy an extended warranty on profits at the electronics chains. ■

—By Robert Berner in Chicago

WARRANTIES

When Service Contracts Make Sense

So you're almost out the door of Big Box with your latest high-tech toy. You've already succumbed to the sales associate's exhortations to buy those expensive Godzilla cables to hook it up to your TV. Then comes the inevitable final pitch: "Would you like an extended warranty for that?"

If you've done your homework, you'll just say no. For what is largely an afterthought in the buying process, extended warranties—or more accurately, service contracts—have become a huge \$15 billion annual business. Typically, at least half of that goes into the seller's pocket as profit, with less than 20% spent on the repair or replacement of products. To put that in gambling terms: The house has set the odds so that for every \$100 it takes in, it pays out only \$20. You're betting against the house. Guess who wins.

That's why consumer organizations by and large counsel against service contracts. "We basically urge people not to buy extended warranties," says Ken McEldowney, executive director of Consumer Action, a San Francisco watchdog group. "The worst ripoff is on appliances, because they have gotten so reliable."

Consumer Reports, the nonprofit product-testing magazine, generally agrees that such warranties aren't worth the money. But in its January issue it cites four products for which they might make sense: treadmills and elliptical trainers because of all their moving parts, plasma TVs because they run hot, and laptop PCs. Even so, the magazine admits that it's relying on a calculated hunch for the first three. "We don't have the data on three-year-old exercise equipment or plasma TVs," says deputy editor David Heim. For laptops, its

survey of owners shows that 33% fail within three years. And it recommends buying the contract directly from the manufacturer rather than a retailer.

If you're offered an extended warranty, here's what to consider before you buy:

How likely is this equipment to break?

Most major appliances either fail in the first year because of defects in manufacturing, when the maker's warranty is still in effect, or after five years, when the extended warranty has expired, as appliance parts wear out.

How much will it cost to replace?

Best Buy charges \$49.99 for a four-year contract on a Magnavox DVD player that sells for \$39.99. Enough said.



Peace of Mind Might Pay Off...

Most experts caution against buying extended warranties for electronic and other equipment. But there are a few exceptions worth considering:

	WHY	TIP
Laptops	One third fail within three years	Buy the extra coverage from the maker, not the retailer
Treadmills, elliptical trainers	Complicated and expensive to repair	A longer warranty costs about the same as a service call
Plasma TVs	They run hot, and cooling fans can wear out	Screen burn-in of static images is not covered

What will it cost me to repair it on my own?

Consumer Reports figures that a vacuum cleaner or lawn mower can be repaired for two-thirds of the cost of a three-year contract. Britain's Office of Fair Trading discovered that consumers pay as much for a five-year contract on a clothes washer as it would cost to repair it four times. How long am I covered by the manufacturer? Most factory warranties cover a year of parts and labor. So the first year of a three-year extended warranty is wasted. And how's this for outrageous: CompUSA charges \$17.99 for a two-year replacement policy on a \$59.99 Netgear Inc. wireless router for home networks—even though Netgear's warranty will repair or replace it free for three years.

Which credit card should I use?

Many card issuers double the manufacturer's warranty for free.

If you decide that paying a premium for a peace of mind is worth it, shop around, even after the fact. You don't have to buy the contract from the retailer, and you don't have to buy it when you buy the goods—you usually have 30 days from purchase. Check with the manufacturer, which often will offer a better deal. For a Satellite laptop PC that sells for just under \$1,000, Toshiba Corp. charges \$199 for a three-year plan that also covers such accidental damage as dropping the laptop or spilling a Coke on the keyboard. CompUSA wants \$369.99 for the extended warranty alone.

If you've already bought a warranty and you're having second thoughts, most states require the seller to give you a full refund if you change your mind within 30 days. At least that's something no casino would allow after you've placed a sucker bet.

—By Larry Armstrong in Los Angeles

Data: Consumer Reports

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Rich College, Poor College

Fever-pitch fund-raising at top-tier universities leaves the others way behind

WITH AN ENDOWMENT of \$3.6 billion under his control and a faculty that boasts seven Nobel laureates, University of Chicago President Don M. Randel should feel on top of the world. But from his office in the heart of Chicago's neo-gothic campus, Randel spends a lot of his time fretting about the university's future. "We are in relentless and ferocious competition with institutions you could name on the fingers of one hand," he says, including Harvard, Yale, Stanford, and Princeton. "And all of them are wealthier than we are." To keep pace, Randel in 2002 launched a \$2 billion fund-raising drive—three times as much as the university raised in its previous campaign, which ended in 1997.

Randel has plenty of company in what has become a frenzy of fund-raising among the nation's leading universities. A generation ago, a \$100 million campaign was big news. Today, 22 universities are aiming to raise at least \$1 billion, and plenty more blockbuster campaigns are on the drawing boards. Experts say that every Ivy League college is planning a \$1 billion-plus campaign. Harvard's next drive "will quite likely be the largest ever," predicts Donella Rapier, vice-president for development at Harvard University, which raised \$2.6 billion in a seven-year campaign that ended in 1999. The betting is that it could reach \$5 billion, nearly twice anything going on now.

The trend is driven largely by an increasing concentration of wealth in the U.S., which has swelled the ranks of the most affluent Americans. With so many more assets to

their name, they have doubled annual giving to higher ed in the past decade, to \$24 billion last year, according to the Rand Council for Aid to Education, a non-profit group. The figure could double again in the next decade, and maybe again by 2020, as affluent Americans bequeath their accumulated assets—estimated at \$41 trillion—to future generations. "There are only so many yachts your heirs need, which leads lots of us to believe we are on the cusp of seeing tremendous growth in how much is given away," says Scott G. Nichols, associate dean of Harvard Law School, where he heads fund-raising.

YAWNING CHASM

WHILE ALL THE MONEY is a boon to the nation's elite universities, it also widens the already-deep chasm between them and the rest of the country's 3,000-plus colleges. This in turn exacerbates the inequality gap between the mostly affluent students who attend the elite schools and the middle-class and poor ones who mostly enroll in less prestigious colleges. Last year, just 20 institutions received \$6.2 billion, or more than a quarter of all higher ed donations. No surprise, Harvard led the pack, with \$556 million, which works out to a staggering \$28,300

for each of its 20,000 students. At the opposite end of the spectrum, 22,000-student Palm Beach Community College in Florida, a typical community college, raised just \$800,000, a paltry \$36 a head.

So while gifts and endowment earnings cover 37% of Harvard's \$2.6 billion annual budget, donations alone provided just 8% at the average U.S. university and less than 3% at community colleges. "Higher education is becoming more and more a two-tier system in which the

A Money Frenzy

The booming ranks of ultra-rich Americans have prompted more universities to hustle for donor megadollars, including 22 with campaigns to raise \$1 billion or more. Some notable drives:

Data: 

HARVARD

SIZE/TIMING The previous campaign, ended in 1999, raised \$2.6 billion

GOALS Now planning what expected to be the largest campaign in U.S. history, possibly aiming to raise \$5 billion.

ENDOWMENT \$22 billion (as of June 30, 2004).





CHICAGO'S RANDEL
A \$2 billion drive
will help finance this
research building

universities turn away 10 applicants for every one they accept, while universities further down are struggling just to fill seats," says Robert H. Frank, an economics professor at S.C. Johnson Graduate School of Management at Cornell University.

Even for the elites, some critics worry at the obsession with fund-raising is fueling an arms race that's driving up the cost of a top-tier education. Already, a startup package for junior science faculty

members at a top college can run into the hundreds of thousands of dollars, while it can take millions to recruit senior scientists. Increasingly, this leaves less affluent colleges behind. "The market for talented professors is as competitive as it is for star athletes," says University of Michigan President Mary Sue Coleman, who in May launched a \$2.5 billion drive.

In this environment, the top private universities are counting on fund-raising to provide their margin of excellence. In

the past, sponsored research—primarily paid for by the federal government—made up two-thirds of the budget at Massachusetts Institute of Technology. Today "it's only 37%, so we've become much more dependent on private giving," says Charles M. Vest, who retired as MIT president on Dec. 6 after leading a \$2 billion fund-raising drive. Similarly, one-third of Yale University's \$1.5 billion budget comes from donations and the endowment, double the portion of a decade ago.

SOARING COSTS

ALL THE NEW CASH funds some laudable initiatives. One key objective is keeping up with the explosion in science. While MIT has long been a leader in engineering, it's now enhancing its brain- and cognitive-

Just 20 schools reaped a fourth of all college giving

sciences department, thanks partly to a \$350 million gift from alumnus Patrick J. McGovern, founder of International Data Group. MIT also finally consolidated its world-renowned computer-science department, which had been scattered

around Cambridge, Mass., into a new \$300 million Stata Center, named for Analog Devices Inc. Chairman Ray Stata, who gave \$25 million to help build it. Similarly, the University of Chicago has earmarked fully half of its \$2 billion fund-raising goal for science, including a \$200 million research building.

The pressure to tap private donors is particularly acute at leading public universities, where state aid hasn't kept pace with soaring costs. Already, gifts and endowment income outweigh state appropriations as a share of the budget at both Michigan and the University of Virginia. No wonder public universities are conducting 12 of the country's 22 billion-dollar campaigns. The University of California at Los Angeles, for example, has

	UCLA	SMITH COLLEGE	WEST POINT
GOAL Has reached its target, ending Dec. 31. Includes \$350 million gift from Patrick J. McGovern, chairman of International Data Group, to create McGovern Institute for Brain Research.	SIZE/TIMING Has already raised \$2.6 billion, topping its target of \$2.4 billion. Drive ends in 2005.	SIZE/TIMING Has so far raised \$383 million toward a \$425 million goal—but plans to continue beyond the original Dec. 31 deadline.	SIZE/TIMING Raised \$218 million ending in 2002, beating original target of \$150 million.
GOALS \$5.1 billion (end of 2003).	GOALS Largest campaign to date by a public university. Includes the largest gift ever to a medical school, \$200 million from DreamWorks co-founder David Geffen.	GOALS Largest campaign ever by a private liberal arts college. Money helped fund first-ever engineering program at a women's college.	GOALS First and largest fund-raising campaign ever by a military academy. Money goes for extras not funded by the Pentagon, including a foreign-language immersion program.
	ENDOWMENT \$1.4 billion.	ENDOWMENT About \$950 million.	ENDOWMENT \$112 million.

raised \$2.6 billion—the most ever by a public university. “Without this campaign, we wouldn’t be able to compete with private universities of comparable stature. We wouldn’t even be close,” says UCLA Chancellor Albert Carnesale.

While the gushers of donor cash mostly help the rich colleges get richer, there

are a few exceptions. In the early 1970s, Boston College, a Jesuit institution, was in the red and nearly insolvent. A series of campaigns, capped by a \$441 million drive ending last year, helped to boost the endowment from \$5 million to \$1.25 billion, which in turn allowed BC to recently recruit professors from MIT and Harvard.

For the most part, the wealth of the private sector is likely to flow to those that already have the most. Such aid helps the country’s top schools continue their global leadership. The majority of American students, meanwhile, will be left further and further behind. ■

—By William C. Symonds in Chicago

COLLEGE ENDOWMENTS

Stealth Fund Drives: Where the Real Money Is

Last May, the University of Michigan pulled out all the stops when it announced its drive, dubbed The Michigan Difference, to raise \$2.5 billion. More than 1,000 wealthy alumni and friends packed the glittering kickoff, while former President Gerald Ford—a Michigan grad—and his wife Betty were introduced as honorary chairs of the campaign. But for all the hoopla, the real drive had been under way for almost four years and had already netted \$1.3 billion.

While this may seem surprising, Michigan’s approach is standard practice in the secretive world of big-time college fund-raising. These days, an elite university’s development office is one of the most sophisticated operations on campus. The University of Chicago now has 250 staffers devoted to the task, while Harvard University has a staggering 620. These people employ cutting-edge data mining to develop detailed profiles of the wealth of alumni and other prospective donors. “Your college probably knows more about you than you do yourself,” says John Butler III, CEO of Barnes & Roche, a leading fund-raising consultant.

A typical campaign unfolds according to well-scripted events, many behind closed doors. Harvard, for instance, is currently in the early phases of hush-hush planning for its next campaign, says Donella Rapier, vice-president for alumni affairs and development. Although Harvard already has a \$22.6 billion endowment—nearly twice that of No. 2 Yale University’s \$12.7 billion—it also has immense ambitions. Among them, says Rapier: strengthening undergraduate education by providing more international experiences and improving the student-faculty ratio. Other objectives include investing in Harvard’s science departments and its public-service schools.

Once a financial goal has been set, the critical quiet period begins, when school

leaders solicit the largest potential donors. At Massachusetts Institute of Technology, former President Charles M. Vest, who retired Dec. 6, held meetings with each of its 100 top prospects. Big donors will make or break a campaign. At MIT, the top 200 gifts ultimately totaled \$1 billion. Michigan estimates that 85% of its \$2.5 billion goal

will come from gifts of \$100,000 or more.

The drawback is that large donors usually want to specify how their money will be used. Some 90% of it comes with restrictions, says John Lippincott, president of the Council for Advancement & Support of Education, which represents college fund-raisers. Thus, when DreamWorks co-founder David Geffen gave \$200 million to the University of California at Los Angeles in 2002, it was earmarked for its medical school, which was then named for him. Garnering such huge gifts can be time-consuming. Michigan spent several years working with Bill and Dee Brehm before they agreed to give \$44 million in November to create a new Brehm Center for Type 1 Diabetes Research.

The focus broadens when a campaign goes public, drawing contributions from as many alumni and others as possible. Universities stage elaborate events, which may seem to be overkill. Michigan, for one, expects hundreds of thousands of gifts for well under \$100,000, but they’re likely to make up only 15% of the total. Still, they usually don’t come with strings attached. And some small fry will become giant donors.

Overall, campaigns can last for seven years. But increasingly, there’s little respite. Although Smith College is closing in on its record-setting \$425 million goal, “we are working on the next five-year horizon,” says its vice-president of advancement, Karin George. Similarly, after Johns Hopkins University finished raising \$1.5 billion in 2000, officials launched a \$2 billion campaign. Add to that a call from the college fund-raising office as one of life’s inevitabilities.

—By William C. Symonds in Boston



A DONOR'S DOLLARS MIT's new Stata Center

How To Be a Billion-Dollar Fund-Raiser

- Develop a compelling case for why your university needs the money
- Compile a detailed profile of the wealth of alumni and other prospective donors
- Start by cultivating your wealthiest potential donors, who will likely provide up to 90% of your goal
- Raise at least 30% to 40% of your goal, to provide momentum, before announcing the drive publicly

Data: Barnes & Roche

RFID

AFTER COMPLIANCE: INTEGRATION AND PAYBACK

**CUSTOMER
DEMAND IS
BUILDING,
SUPPLIERS ARE
RACING, AND A
FLOOD OF RFID
APPLICATIONS IS
ABOUT TO
INUNDATE THE
INDUSTRIAL AND
CONSUMER
LANDSCAPE**

An elderly woman dozes quietly in her hospital bed, tucked under layers of blankets. Her physician stops by on his rounds and clicks on his wireless tablet PC, which is equipped with a radio frequency identification (RFID) reader. This device transmits a signal to an RFID tag in the woman's hospital bracelet, even though it's hidden by the bedding. The tag transmits information to the PC, which is integrated with the hospital's information management system. On the display, the doctor sees the woman's name, her previously administered medications, plus recently collected vital information, such as temperature, heart rate, and blood pressure. Without disturbing the patient or having to check back at the nursing station, the doctor has received the accurate, up-to-date information he needs.

The patient is fictional but the application of the technology is real. The hospital, Jacobi Medical Center in the Bronx, benefits tremendously from a Siemens RFID system, according to chief information officer Daniel Morreale. "We get 100% accuracy in identifying patients and an overall savings of clinician time because doctors and nurses get the patient



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RFID

information they need at the bedside," he says. "This enhances patient care, supports our safety goals, and enhances the patient's experience by limiting disturbances."

Despite the recent spate of media coverage, RFID is not new. Innovative companies and organizations have been using it for a decade or more in so-called "closed loop" systems, much like the one at Jacobi — systems in which information is rapidly and accurately transmitted among parties within the organization. Businesses with logistics operations — such as automotive, consumer packaged goods, manufacturing, government, and retail — have been quick to embrace RFID. Yet the recent mandates from industry giants such as Wal-Mart, the U.S. Department of Defense, and others have thrown a new spotlight on RFID. Companies are considering how the technology can be used to transmit information in an "open loop" to their suppliers, customers, and other business partners outside their own four walls — thereby enhancing product visibility, increasing sales, and boosting profits.

As a result, the focus on RFID has turned laser-sharp across the business world — both for companies that are already suppliers to Wal-Mart and for organizations that recognize and value the benefits that the technology can clearly deliver. For many companies, the proven benefits of RFID in applications like Jacobi's have already answered the question of whether or not to embrace the technology. For them, the next step is to dig deeper to gain a better understanding of RFID's critical integration and payback concerns.

JOINING SAM'S CLUB

By Jan. 1, Wal-Mart's top 100 suppliers are required to begin applying RFID tags to cases or pallets of products being shipped to three specific distribution centers as well as 150 stores. By October 2005, Wal-Mart will expand the requirement to three additional distribution centers and another 900 stores, and the next 200 largest suppliers will also have to come on board.

This aggressive schedule has pushed RFID technology into the forefront, with the entire industry responding

WITH CUSTOMER DEMAND EXPLODING AND CHIP AND TAG MAKERS RACING TO ACCOMMODATE THAT DEMAND, "THE RAPID COURSE OF CHANGE THAT'S OCCURRED IN THE LAST 12 TO 18 MONTHS HAS BEEN UNLIKE ANYTHING I'VE SEEN IN THIS INDUSTRY BEFORE."

DAN MULLEN, PRESIDENT OF
AIM GLOBAL

"Even since last spring, the world of RFID has changed dramatically," agrees Bob Cornick, vice president and general manager for RFID for Zebra Technologies Corp. in Vernon Hills, Ill. "The industry has faced and met a number of challenges, and the collective knowledge has grown tremendously."

MEET IN THE MIDDLE

Perhaps one of the greatest challenges in using RFID effectively is integrating it into a company's existing IT architecture. While experts agree that linking RFID with other auto-identification technologies, such as bar coding, is fairly straightforward, connecting it to enterprise systems is a bit more complex.

"Introducing RFID into a company's business processes requires a commitment from the company in partnership with competent technology providers," explains Rick Bauer, senior technical director of RFID technical research for Paxar Corp., a manufacturer of RFID, bar code, and retail merchandising systems, based in White Plains, N.Y. "The hardware issues — such as incorporating additional data streams into label printers or understanding where to place labels and antennae on products — are easily manageable with the right partner. But controlling and manipulating the information you receive from these

systems, then using it within your enterprise and sharing it with your suppliers, is much tougher."

The source of this challenge is the need to filter and process huge volumes of data collected by the RFID system so that it does not overwhelm a company's back-office

"WE NEED MORE TIME FOR THE USER COMMUNITY TO DETERMINE WHICH BEST PRACTICES SHOULD BE INTEGRATED INTO THE TECHNOLOGY."

JOE DUNLAP, A SPECIALIST IN RFID
FOR SIEMENS CORP.

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RFID

business software, such as enterprise resource planning (ERP) systems. Even with filtering and pre-processing, the amount of data collected with RFID systems may be staggering compared to what is currently collected. Many established ERP solutions are not yet prepared to efficiently accept RFID data. Once accepted, the data must be processed and converted into documents that can be used by business partners, such as advance shipping notices (ASNs) in retail.

The key to solving this problem is "middleware" — software that is specially developed to connect one system with another. In most industries, middleware for RFID is relatively new — but maturing quickly. "As companies begin to expand their RFID systems from simple tag and reader configurations, integrating with other business systems using middleware will become the primary challenge," explains Mike Wills, vice president of global services and RFID for RFID technology provider Intermec Technologies Corp., of Everett, Wash. "Two years ago, people weren't thinking about this at all. Now, as they start considering how this technology can help them throughout the enterprise, they understand that they need help. Often that requires an integration partner who can help with core-business—process re-engineering."

Another integration challenge is that companies have yet to determine which practices should be incorporated into

"AS COMPANIES BEGIN TO EXPAND THEIR RFID SYSTEMS FROM SIMPLE TAG AND READER CONFIGURATIONS, INTEGRATING WITH OTHER BUSINESS SYSTEMS USING MIDDLEWARE WILL BECOME THE PRIMARY CHALLENGE."

MIKE WILLS, VICE PRESIDENT OF GLOBAL SERVICES AND RFID FOR INTERMEC TECHNOLOGIES CORP.

their RFID systems. Consider the case of a forklift operator who places pallets of products on warehouse shelves, says Joe Dunlap, a specialist in RFID for Siemens Corp., in Mason, Ohio, which provides RFID technology solutions across multiple industries. Typically, the operator uses a bar code scanner to read the proper location when placing a pallet in the warehouse. When he finds the proper shelf or bin, the operator scans its placard and positions the pallet. Approximately 1% to 3% of the time, however, the operator scans the correct placard,

but puts the pallet in an adjacent bin. This creates the possibility that products will be picked incorrectly or considered out of stock even when they are in the warehouse, resulting in poor accuracy, customer dissatisfaction, and higher direct labor costs.

With an RFID solution, the operator would not need the bar code scanner, because the tags could be read automatically by a mobile reader on the forklift. If the pallet were placed incorrectly, the system could recognize the error and notify the operator to correct the problem. If the operator did not make the correction, the system could notify his supervisor or even prevent the operator from making additional transactions until the mistake was corrected. Systems could also be configured to accept the error and reassign the storage location.

COMPLIANCE IS THE FIRST STEP

Some companies are approaching RFID in stages. At Conair Corp., a Stamford, Conn., maker of personal and health-care appliances, complying with Wal-Mart's mandate is critical. Wal-Mart is one of Conair's top five customers, receiving between 800,000 and 1.2 million cases of products annually. "Our corporate

culture is to service our customers in the way they desire," says Tom Michlik, a Conair logistics analyst.

Conair is using printers and tags from Paxar Corp. to comply with Wal-Mart's RFID mandate this year and Target's in 2005. As a first step, the company is applying tags to master cartons of goods, but is not yet using any RFID stockkeeping units (SKUs) in its own systems. In mid-November, Conair was just beginning to go live with the technology,

having purchased 30,000 tags and new printers.

The biggest cost, Michlik says, was the internal IT labor hours needed to modify the company's warehouse management software so it could handle the new technology. "We didn't want to purchase middleware or upgrade our software at this time," he says, "so we made the decision to customize our software internally to handle the RFID requirements."

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RFID

"If users began asking for a solution that could support this type of best practice, RFID vendors would begin delivering," says Dunlap. "In addition, warehouse management vendors would incorporate these processes into their software. But today, we need more time for the user community to determine which best practices should be integrated into the technology."

GO DEEP FOR A TOUCHDOWN

Another critical topic for companies considering using RFID is payback. Experts agree that businesses using RFID only to meet a customer mandate typically get little if any return on their investment. So-called slap-and-ship applications — where RFID tags are applied just to the pallets or cartons being shipped to the customer mandating the initiative, without any tracking of the information that can be gathered from the technology — do little except ensure that the supplier retains the customer.

"Suppliers will actually get negative ROI if they do only slap and ship," says Mark Verheyden, vice president of marketing for automatic identification vendor Accu-Sort Systems Inc., in Telford, Pa. "You get less negative ROI when you use automated tag applicators. You start to get positive

"THE WORLD OF RFID HAS CHANGED DRAMATICALLY. THE INDUSTRY HAS FACED AND MET A NUMBER OF CHALLENGES, AND THE COLLECTIVE KNOWLEDGE HAS GROWN TREMENDOUSLY."

BOB CORNICK, VICE PRESIDENT
AND GENERAL MANAGER FOR RFID,
ZEBRA TECHNOLOGIES CORP.

ROI only when you capture and manage tag data and integrate it into your warehouse management system to allow your distribution center to work more efficiently."

For companies that are willing to extend their implementations to support sales and replenishment, however, the rewards can be great. First, companies gain a better understanding of what happens to their products after they leave the facility. Shipments are easier to track, making it easier to be paid for goods and to see when

problems occur in the logistics process.

Second, companies can take action based on the information they receive. For example, if product deliveries are delayed, the company can use the data to demand better service from the carrier. The data can also be used to improve on-time shipments to customers, which can help prevent charge-backs and non-performance penalties. The RFID system can also show when products have been delivered, providing critical documentation needed to obtain customer payment. If supply chain partners share data, manufacturers can even adjust their production and shipments based on the retailer's sales. By having the right products in the right store at the right time, the manufacturer can boost sales and profit

TOP FIVE RFID MISCONCEPTIONS

1. We can't get the tags we need.

"Supply and demand for RFID tags is temporarily unbalanced," says Bob Cornick of Zebra Technologies.

"Initially, the anxiety of users made them reluctant to place orders, so manufacturers slowed production. Now, as companies are ordering more tags, manufacturers are increasing capacity. But by the first quarter of 2005, supply and demand will be balanced again."

2. We're mandated to have 100% read rate at the case level

"Today's mandates do not include demands for 100% read rates for

labels on individual cases, but they do expect 100% read rates for pallet labels," says Rick Bauer of Paxar Corp. "This expectation will become more aggressive, even for the case label, as the chip and antenna technology continues to develop."

3. Best wait until standardization drives down tag costs.

"We're in a snowflake industry right now," says Mike Wills of Intermec Technologies. "Until we get out of this boutique mentality, where each chip is designed specifically for an industry or a company, we won't see prices below \$.10 per tag on the street."

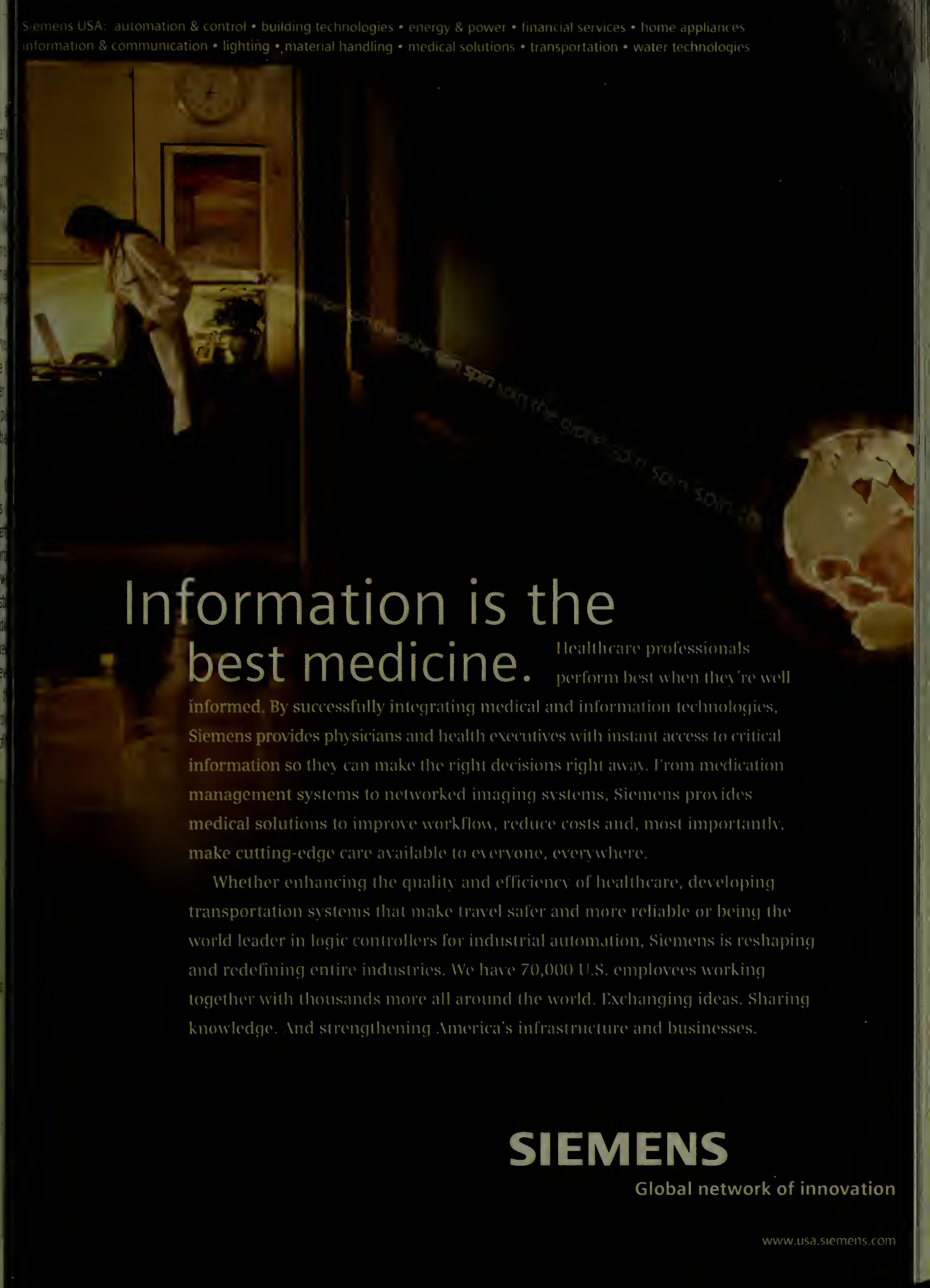
4. Compliance is too difficult.

"In general, compliance is easier

than companies thought it would be even as late as last summer," says Zebra Technologies' Cornick. "Creating a fully integrated approach and getting a complete ROI still takes some effort. But complying with the customer mandates is fairly easy to do."

5. Once you can use RFID to ship to Wal-Mart, you're done.

"Slap and ship isn't the end of the line, it's the start," says Mark Verheyden of Accu-Sort Systems Inc. "Once the first deadline passes in January, the tagging volume will increase. Then Wal-Mart and its suppliers will need to focus on how to ramp up and how to make RFID work even more efficiently and cost-effectively."



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In hospital applications such as at Jacobi Medical Center, RFID can be used to track and better manage assets, such as wheelchairs and medical devices, locating them faster for patients and reducing theft. When medications and dosages are tagged, doctors and nurses can ensure that the right medicine is dispensed in the right amount to the right patient at the right time.

"RFID will go through a process similar to what

happened with bar code technology 20 years ago," says Mullen of AIM Global. "Initially, people thought they couldn't afford the technology. As it became more widespread, the payback grew. Now companies couldn't do without it. The emergence of RFID in the retail supply chain will drive further adoption. As companies implement the technology deeper within their operations, the return on investment will grow and the applications will expand." ■

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AIM Global

<http://www.aimglobal.org> <http://www.rfid.org>

Intermec Technologies Corp.

<http://www.intermec.com/rfid>

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Going The Hybrid Route

How mutual funds that ape hedge-fund tactics can help you profit from a tepid market. **BY ANNE TERGESEN**



WHY BOTHER WITH plain old mutual funds if you can qualify for a hedge fund? After all, these private investment pools seem like the ideal way to navigate an era of low returns, since they use sophisticated tools—off-limits to most mutual funds—to make money whether stocks rise or fall. But some recent research suggests you may be able to cover much of the same terrain with a handful of mutual funds that mimic hedge fund strategies yet are cheaper and more tax-friendly. That's not to say that these hybrid mutual funds are perfect substitutes. Hedge funds come in more investment styles than their mutual fund look-alikes. Moreover, since hedge funds operate outside the regulatory framework that governs mutual funds, they tend to be more flexible. For example, while mutual funds are permitted to

borrow \$1 for every \$3 they hold in assets hedge funds can use as much borrowing or "leverage," as their brokers allow to amplify returns, protect against a stock market decline, or engage in other strategies says Steven Felsenstein, a partner at law firm Greenberg Traurig in Philadelphia. Some mutual funds are further constrained by self-imposed limits. Consider the Hussman Strategic Growth Fund which in its prospectus says that it expects never to have a net "short" position, or a big bet on a stock market decline.

BEAR MARKET GAINS

STILL, MUTUAL FUNDS that follow hedge fund playbooks share some of the qualities that make hedge funds so attractive. Several, for example, posted gains during the bear market. There's even some evidence that these funds can



perform as well as comparable hedge funds. According to a recent study that examined the risk-adjusted returns of 12 hybrid funds between 1998 and 2003, half outperformed the hedge fund indexes they most resemble. "Hybrid mutual funds do offer some return opportunities and characteristics that similar hedge funds provide," says Thomas Schneeweis, director of the Center for International Securities & Derivatives Markets at the University of Massachusetts at Amherst, which published the study.

One advantage hybrid mutual funds have over hedge funds is lower expenses. The hybrids' 1.82% average expense ratio is high for mutual funds but is a bargain for hedge funds, which typically pocket a 1% to 2% management fee plus 20% of the profits, according to the Hennessey Group, a New York adviser to hedge-fund investors. For many, the cost of hedge-fund investing is higher still. That's because in order to get exposure to a diversified portfolio of hedge funds, most individual investors buy into a fund-of-funds. These pass along not only the fees of the hedge funds they invest in, but also tack on an extra 1% in management fees and a 10% cut of the profits for themselves.

Many hedge funds—mostly in the fund-of-funds category—also impose hidden tax costs. For example, a fund-of-funds that earns 11% will put an 8.9% return in your pocket after it takes its 1% management fee and 10% cut of the profits. Still, you could easily wind up paying tax on more profit than you receive—even on the full 11%. Why? A majority of fund-

of-funds classify their fees as "miscellaneous itemized deductions" on the K-1 tax forms they distribute. Because of how the tax laws work, "most taxpayers aren't able to use those deductions" to offset their taxable income—or, in this case, the 11% return, says Robert Gordon, president of Twenty-First Securities, a New York brokerage.

To see why, consider a taxpayer with \$500,000 of adjusted gross income and \$5,000 in hedge fund-of-fund fees. Since taxpayers can claim only "miscellaneous itemized deductions" that exceed 2% of their adjusted gross income, the first \$10,000 of this taxpayer's investment fees can't be used to offset taxable income. As a result, none of the \$5,000 in fees paid are eligible for the deduction, and so the taxpayer must pay tax on the fund-of-funds' full 11% profit, despite receiving a gain of only 8.9%. Mutual funds don't have this problem since investors pay tax on the profits that remain after fees are deducted.

Hedge funds can create other tax headaches. If your fund sells a profitable investment, you'll have to pay tax on your gain—even though you won't receive your share of the profits until you cash out. Mutual fund shareholders, in contrast, can opt to receive an annual check for their portion of any taxable profits.

**They're
tax-
friendlier
than
hedge
funds**

Hedge Fund Wannabees

Here are some mutual funds that use hedge fund investment strategies.

FUND/SYMBOL	3-YR. AVG. ANNUAL TOTAL RETURN*	EXPENSE RATIO
Baron Partners BPTRX	18.20%**	1.40%
Legg Mason Opportunity LMOPX	14.26	1.90
Hussman Strategic Growth HSGFX	12.88	1.25
Laudus Rosenberg Value Long/Short Eq. BRMIX	7.71	3.06
Gateway GATEX	4.36	0.97
Needham Growth NEEGX	2.23	1.77
Boston Partners Long/Short Equity BPLEX	1.81	3.32
Metropolitan West Strategic Income MWSTX	N/A	2.35
CON Long/Short IOLCX	N/A	2.30

*Appreciation plus reinvestment of dividends and capital gains, three years ended Dec. 6, 2004 **As of Nov. 30

Source: Morningstar Inc.

BIG DIFFERENCES

WHEN PICKING A HYBRID mutual fund, read the prospectus carefully because the funds can vary considerably. Although both the Hussman Strategic Growth Fund and the Legg Mason Opportunity Trust can hedge—or reduce—their exposure to the market, the Hussman fund sometimes is as much as 100% hedged. (Currently it's at 75%.) In contrast, Legg Mason Opportunity had no hedge in place as of its latest filing on Sept. 30. In the first quarter, short positions comprised 22% of the fund's net assets. Run by star stock picker Bill Miller, the fund also has about 3.1% of its assets in three private partnerships.

Unfortunately, some hybrid funds with strong track records are closed to new investments. Among them: The Calamos

Market Neutral Fund and the Merger Fund—up an annual average of 8.3% and 4.9%, respectively, over the past five years. But keep checking: Neither rules out reopening if new opportunities arise.

Still, some good opportunities remain, says Rick Lake, a Greenwich (Conn.) adviser who specializes in both hedge and hybrid funds. Among Lake's favorites: the

Metropolitan West Strategic Income Fund, a newcomer that invests in a variety of strategies, many in the fixed-income arena. It's up 6.7% over the past year.

Another pick of Lake's is the Gateway Fund, which sells call options on its holdings. That way, it pockets income—albeit in return for giving away some upside potential. It then buys put options with some of

the proceeds to protect against a steep off. The fund is up an annual average 4.36% over the past three years. Holdings include Legg Mason Opportunity and Hussman Strategic Growth, up an average annual 14.26% and 12.88%, respectively, over the past three years after fees of 1.9% and 1.25%. Why pay more than you have to for hedge-fund returns? ■

Gadgets

Baby, Is It Cold Outside?

Home forecasts go high-tech. **BY LARRY ARMSTRONG**

NOTHING—WITH THE possible exception of time—affects the routine of daily life more than the weather. It dictates how you dress, how early you leave for work, and whether you go to that football game. Many of us keep our radios set so we hear the weather report as soon as we wake up. But if you want to know the weather closer to home than the nearest airport, you can get a gadget that tells you what's doing right outside your door.

I installed a \$15 Weather Channel indoor/outdoor thermometer from La Crosse Technology. It stores highs and lows, and what time they occurred, for the past 24 hours. I also set up a \$500-plus Vantage Pro2 weather station from Davis Instruments in my backyard. It's the top-of-the-line in amateur weather gear, measuring everything from wind speed to rainfall and giving me personal forecasts.

Mostly, high-tech weather reporting has gone wireless: You no longer have to drill a hole in the wall and thread a cable through to read the outdoor temperature from inside

the house. All the outside sensors transmit their readings several times a minute to a liquid-crystal display console that sits on a desk or mounts on a wall.

For about \$30, you can get thermometers from La Crosse or Oregon Scientific that also measure humidity and keep track of barometric pressure trends. That means they can predict the weather for the next 12 to 20 hours, displaying their forecasts with icons for sunny, partly cloudy, or rain, for example. If you spend \$50, they will come with a clock that syncs itself to the U.S. atomic clock in Boulder, Colo. At \$100, you can add a rain gauge, or an anemometer to measure wind speed and calculate the wind chill.

More expensive devices track weather variables for longer periods, such as a season's worth of rainfall, and link to a computer for recordkeeping. They also can sound alarms when criteria you set are met, warning you, say, to bring your plants in when frost is predicted. La Crosse's WS-2310 weather station measures pretty much the same things as the rugged Vantage Pro model from Davis. It's just not as sophisticated. But priced at under

KESTREL 2500 The handheld weather meter is the size of a cell phone



\$200, it's a lot cheaper, too.

If you want to know the weather wherever you go, check out a handheld weather meter. Nielsen-Keller makes six models, each the size of a phone. They range from a simple weather meter, about \$65, good for golfers and windsurfers, to the \$250 Kestrel 40, which can track virtually everything backyard models do, except for rain. A good bet is the new 2500, which sells for about \$150. It's just the gizmo for figuring out the wind chill on the slopes, or the temperature of the hot tub afterward.

VANTAGE PRO2 Outside sensors send readings to the console (top)

The first award for performance that has nothing to do with red carpets, limousines, or plunging necklines.

The recipients of the first annual CMO of the Year Award were selected by their peers: Chief Marketing Officers and top decision makers from America's most dynamic companies in technology and communications. This award recognizes those CMOs whose market vision, strategy, leadership and creativity are building value, momentum and uplift in their respective industries. In addition to the winners, the CMO Council and BusinessWeek salute this year's finalists: AMD, Cisco, Dell, EMC, Mercury Interactive, palmOne and Salesforce.com, for a job well done. CMO Council members represent nearly 1,000 technology companies with aggregated annual revenues of over \$500 billion. They control more than \$40 billion in annual marketing spend.



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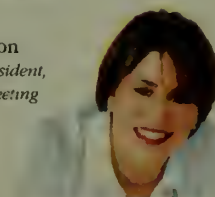
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Your Online Paperboy

How Really Simple Syndication delivers just the Web sites you want. **BY HEATHER GREEN**



IF YOU'RE A NEWS JUNKIE, AN online auction lover, or someone who wants to know when the latest songs, DVDs, and books are released, here's a technology that's perfect for you. Called Really Simple Syndication (RSS), it lets you pull together a list of Web sites you want to follow. So instead of surfing through *The New York Times* site for news, going to eBay to track a particular auction, or checking with Apple's iTunes to see when a new recording is available, you can get access to all the information through one Web page or download to

your computer. The information you get, called a feed, comes to you through a piece of software called a newsreader.

RSS has simplified my job as a technology reporter. I used to visit a dozen sites every hour or so, from the geeky blog Slashdot to CNET's online news service, to check up on tech news. But since I signed up for Bloglines, a free RSS service, I can scan all my favorite sites for the latest developments in a minute or two.

The simplest way to get started with RSS is with My Yahoo!, a personalized service of Yahoo! that's free to any registered user. To set up RSS feeds, go to the

main My Yahoo page and click on the "Add Content" link. That takes you to a page where you have three options. Yahoo provides two preselected groups of feed to choose from—entitled Editors Pick and Most Popular. These offer a range of sites including *USA Today*, ESPN, and the satirical newspaper *The Onion*. You can also customize a list by typing the RSS of your favorite sites into a box or using a specialized search engine to find sites using keywords. Your choices appear as a list of headlines and story briefs on your My Yahoo page.

SUBSCRIBERS ONLY

HOW MUCH INFO each feed provides depends on the publisher or e-tailer. Some publishers, such as the popular political gossip blog *Wonkette*, post entire items while ESPN, *The Wall Street Journal*, and others provide only a headline or synopsis. To read the full text, you click on the item and go to the publisher's site. You will still need to have subscriptions to sites that require them.

Bloglines is a more sophisticated RSS option than My Yahoo. What's especially helpful about Bloglines is a little bit of software you download that sits on your desktop toolbar and alerts you whenever updates come into the sites on your list. By contrast, the only way to check for updates at My Yahoo is to go to the site. Bloglines also shows the colorful graphic and pictures that go with the news item.

If you want to avoid the extra step of logging on to the Internet, a range of downloads directly to your computer let you track your RSS lists. NewsGator folds into the Outlook e-mail software. Ideal for people who live in e-mail, it is listed on the left side of the Outlook screen, along with such items as inbox and calendar. FeedDemon is software you download that sits on your desktop, like an instant messenger program. They sell for \$29.99 online and contain no ads. Pluck integrates directly into the Internet Explorer browser, appearing as a list of feeds on the right side of the browser window. It's free but splashes ads under the feeds.

Getting hooked on RSS is easy. But this is an addiction that could save you time and improve your productivity. ■

Getting the News to You

These services search the Web and deliver the news you want

BLOGLINES

Online newsreader with desktop alerts and the ability to share items (bloglines.com)

FEEDDEMON

Its intuitive screen makes this desktop software well worth the \$29.99 cost (feeddemon.com)

MY YAHOO

A stripped-down, easy-to-use Web service that's free and perfect for novices (my.yahoo.com)

PLUCK

This free software fits snugly within the Internet Explorer browser (pluck.com)



ICE PALACE
Looming above
is the Cathedral
of St. Paul's

Bring Your Parka, And Party

Minneapolis-St. Paul is a winter carnival of skating, skiing, and shopping. **BY ELLEN HOFFMAN**

LEGEND HAS IT THAT IN 1885 a New York newspaper reporter labeled St. Paul, Minn., "another Siberia, unfit for human habitation." Every year since, the city has tried to shed down that reputation by staging a series of events, from an ice-carving contest to fireworks and parades, known as the St. Paul Winter Carnival. Minneapolis—the other half of the Twin Cities—also offers wintertime activities that can almost make you forget temperatures below 10F. Besides bundling, the key to enjoying the experience is striking the right balance between time spent inside and outside. The St. Paul Carnival, which runs Jan. 1–Feb. 6, gives you plenty to do in both heated and unheated venues. Outdoors, you can watch the ice and snow sculptors

in action or take an evening stroll among their creations in festively lit Rice Park. When the chill is too much, warm up in the conservatory at Como Park, heated to a temperature better suited to the more than 400 varieties of orchids that will be on display there Jan. 29–30. You can also see an exhibit of Carnival memorabilia housed in the late-19th-century mansion of Great Northern Railway baron James J. Hill. For complete details, go to wintercarnival.com. It will be easier to stay warm if you participate in the activities, not just watch them. For skaters, there's the Winter Carnival rink near Landmark Plaza in St. Paul or the rink at the recently renovated Milwaukee Road Depot, a Renaissance Revival train station built in downtown Minneapolis in 1899. Cross-country skiing is available at Theodore Wirth Park, also in Minneapolis. Downhillers can rent

skis or a snowboard at the Como Ski Center in St. Paul. Intrepid joggers and power walkers may join the hundreds of locals who brave the cold to exercise on paths around some of the 22 natural lakes within the Minneapolis city limits.

HEATED SKYWAYS

IF YOUR FAVORITE sport is shopping, you can always visit the mammoth Mall of America, which also features the Camp Snoopy theme park and an aquarium. The mall is in Bloomington, about a 10-minute drive from the Minneapolis-St. Paul International Airport. You can also get there by a 35-minute ride on the new Hiawatha Light Rail line

from downtown Minneapolis.

Picking a good place to bed down for the night can make a big difference in combating the chill. Both cities have an extensive system of enclosed walkways above street level. If you choose a hotel in or close to the skyway system, you'll be able to stroll to restaurants, shops, movie theaters, and nightclubs and leave your parka and mittens in the hotel room.

Skyway-linked hotels in Minneapolis include the luxury Marquette, the Radisson Plaza, and Le Meridien. In St. Paul, hotels on the skyway route include the Radisson Riverfront and the historic Saint Paul Hotel, which overlooks Rice Park and was designed by the architects of New York's Grand Central station. Its restaurant, the St. Paul Grill, with burnished dark wood walls and a steak-and-seafood menu, is one of the area's best. Another is Fhima's, where the eclectic Mediterranean cuisine ranges from bouillabaisse to Moroccan stews.

You can start the day in Minneapolis on 10th Street, near the Nicollet Mall, at Hell's Kitchen restaurant. Choose traditional pancakes or lemon-ricotta hotcakes. On Sunday mornings, the servers wear flannel pajamas and slippers.

Like many twins, Minneapolis and St. Paul are closely related but geographically distant. Unless you want to take a 40-minute bus ride or \$20 taxi to cover the 10 miles between their downtowns, you'll need to rent a car. Don't leave the lot without one vital piece of equipment: an industrial-size ice scraper. ■

Banks Go Beyond Toasters

Signing up for a package of services can give you convenience and discounts. **BY JUSTIN HIBBARD**



ZACH MAXFIELD SPENDS a lot of time talking to bank salespeople. As an associate at Second Curve Capital, a New York hedge fund that specializes in bank stocks, he regularly phones branches to gauge their sales acumen. But nothing prepared him for the woman who answered his call at a Bank of America branch in October. "I knew that banks were going crazy for cross-selling lately, but I didn't realize just how

crazy," he says. All Maxfield wanted was the current money-market rate. But the woman pitched him a package that included two checking accounts, two savings accounts, a credit card, a debit card, and online banking.

Would you like fries with that? If you've heard that line, you're familiar with cross-selling. By offering discounted products to complement the one you're already buying, companies look to get more business. Banks have gone gaga for this approach, and to many people that's

welcome news. According to research firm TowerGroup, 70% of U.S. consumers would like to have all of their accounts at one financial institution—as opposed to the average of four they now have spread across.

If you have at least three accounts at a combined balance of \$10,000 or more, you're likely to benefit from a bank package. By aggregating accounts, you could save hundreds of dollars a year in fees and qualify for higher rates on savings and lower rates on loans. But if you don't maintain the minimum balance, watch out—you'll get soaked on fees. Don't sign up for a package before shopping around and calculating the potential savings.

A Bundle of Savings

Banks have been pushing **packages of products** that include no-fee checking and savings accounts, free checks and debit cards, and free online banking and bill paying. The three banks below offer the following additional services:

BANK OF AMERICA Prima

- Free traveler's and cashier's checks
- Free safe-deposit box
- Bonus interest rates on CDs, IRAs, and savings
- Free stop-payment orders
- No charge for additional Prima account

WACHOVIA Crown Banking

- Free traveler's checks, cashier's checks, and money orders
- Free safe-deposit box
- Free incoming wires
- Two withdrawals per month from other banks' ATMs with no Wachovia fee
- Free statements at Wachovia ATMs

WELLS FARGO Portfolio Management Account

- Free traveler's checks, cashier's checks, and money orders
- Discounted safe-deposit box
- Bonus interest rates on CDs and savings
- No Wells Fargo fee for unlimited transactions at other banks' ATMs
- Discounted loans and home mortgages
- 10 free stock trades on new brokerage account
- Credit-card reward program with no annual fee

WAIVING FEES

START BY FIGURING out which package you qualify for. Most let you combine balances from several accounts to meet minimum and avoid fees. For example, you keep the total deposits in your checking, savings, certificates of deposit, and individual retirement accounts above \$10,000, you qualify for Bank of America's Prima package and a waiver of \$20 month in service charges. Other packages have age requirements. For customers who are 50 or older, Wachovia offers Crown Classic Banking, which provides benefits such as no fees on early CD withdrawals for health-related emergencies.

You may be able to sign up for a package at your current bank without changing your accounts. That's what happened



COMMENTARY

BY CHRISTOPHER FARRELL

The Importance of Independent Thinkers

Why to consider concentrated funds for your mix

RON BARON, JAMES Gipson, Bill Miller, and Robert Torray are mutual fund managers who stand apart from the crowd. While the average equity fund might have 80 to 100 stocks, these have 20 to 30 companies and thus, much larger stakes.

They're patient investors, too, amassing their positions over time.

Through the years, such managers have racked up winning records. In one study, fund researcher Morningstar found that more than 80% of concentrated funds beat their more diversified peers in six of the seven domestic equity fund categories. That study measured rolling five-year returns from 1992 through 2003.

While funds run by independent thinkers like Legg Mason's Bill Miller belong in most portfolios, they have downsides. Though multi-year returns

are great, any one year may not be—and 2004 is one of them (table). One problem with this style of investing is that it tilts toward companies that are out of favor and mostly shunned by Wall Street. Sometimes it takes longer than expected for one-time basket cases to become stars, or they continue to go down before they go up. "You can't worry about being down a few percent," says Gipson, longtime manager of the Clipper Fund. "You

do your homework and concentrate on your best ideas."

The other problem with concentrated investing is when a stock sours, it can do some serious damage. For instance, Baron's firm collectively lost \$566 million in two large stakes from December, 1995, through October, 2004: the art auction house Sotheby's Holdings and AMF Bowling Worldwide.

To avoid that again, Baron is dialing back on concentration. Now, five of his six funds can't have more than 10% of assets in any one stock. In addition, his six funds together can't own more than 10% of a single stock. "This won't eliminate losses," says Baron. "But when we make a mistake, we don't want to lose as much."

Baron shareholders will not likely complain about these changes, since this year's returns range from 10% to nearly 37%. But such limits could cap the potential gains you can get from letting the winners run. Mutual-fund investors will lose out if focused

managers start getting myopic about results and damp their concentrated strategies.

If people could invest in only one fund, a concentrated fund would be risky. But no one owns just one fund anymore. Using index funds, investors can gain plenty of diversification at a low cost. What they do need in their portfolios is the unconventional wisdom that these stockpickers have to offer. ■

Many Focused Funds Lag

FUND (SYMBOL)	2004 RETURN*
Baron Asset (BARAX)	22.2%
Clipper (CFIMX)	2.9
Legg Mason Value (LMVTX)	6.7
Oak Value (OAKVX)	4.8
Sequoia (SEQUX)	3.4
Torray (TORYX)	5.0
Standard & Poor's 500	7.0

*Appreciation plus reinvestment of capital gains and dividends before taxes. Jan. 1-Dec. 6, 2004

EDITED BY TODDI GUTNER



HEALTH

Heart-warmer

AMID THE HOLIDAY MERRIMENT, a serious item tops the wish lists of **Amazon.com** customers: the **Philips HeartStart**, a portable defibrillator to treat victims of sudden cardiac arrest. Though not a sexy gift, it's a smart one: 80% of sudden cardiac arrests occur at home, and only 5% of all victims receive the electrical charge called defibrillation in time to restart their heart and breathing.

Cardiac arrest can occur without warning or risk factors. If you suspect your companion is going into cardiac arrest, you pull the handle on the front of the HeartStart, activating voice prompts that guide you through a few simple steps. Step one requires you to place the device's two adhesive pads on the victim's bare chest to determine whether the problem is cardiac arrest. If arrest is confirmed, the machine will instruct you to press a button to start defibrillation. If it's not cardiac arrest, the machine will tell you that—and it won't defibrillate. Voice prompts will also guide you through cardiopulmonary resuscitation. At \$1,495 on **Amazon.com** and **Drugstore.com**, the HeartStart—which was cleared by the FDA in September for nonprescription use— isn't cheap. But it might prove priceless. —Kate Hazelwood

TAXES

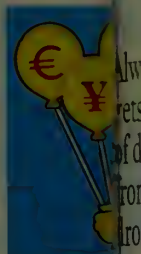
AS YOU CLOSE the books on the 2004 tax year, it's not too early to start thinking about next year. Here are some changes from the Internal Revenue Service that are effective **Jan. 1**:

- » **MAXIMUM 401(k) CONTRIBUTION:** \$14,000, or \$18,000 if you're 50 or older
- » **TOP IRA CONTRIBUTION:** \$4,000, or \$4,500 if you're 50 or older
- » **STANDARD DEDUCTIONS:** \$5,000 for single or married filing separately; \$10,000 for married filing jointly, \$7,300 for head of household
- » **MILEAGE DEDUCTIONS:** 40.5¢ for business; 15¢ for moving or medical; 14¢ when doing charitable work
- » **LONG-TERM CARE INSURANCE DEDUCTION:** age 40 or less, \$270; 40+ to 50, \$510; 50+ to 60, \$1,020; 60+ to 70, \$2,720; over 70, \$3,400
- » **HEALTH SAVINGS ACCOUNT LIMIT:** for a single taxpayer, \$2,650; for a family, \$5,250

INVESTMENTS

A CURRENCY PLAY FOR HIGH ROLLERS

INVESTORS WHO THINK the dollar has farther to fall have been pouring money into foreign stocks and bonds. But there's a purer play: foreign currencies. With the dollar sliding 9.5% against the euro since June 1, **JPMorgan Private Bank's** investments in options on baskets of currencies have become more popular. One offers exposure to five Asian currencies, the other to the yen, euro, peso, pound, and Canadian dollar. Depending on the vehicle, buyers are guaranteed most of their initial investment. Don't pull out your wallet unless you're a high roller: Minimum investment is \$100,000. —Carol Marie Cr...



BEVERAGES

A BLOOMIN' POT OF TEA

HERE'S AN ARTFUL GIFT for a tea lover: a bamboo chest filled with tea leaves hand-sewn with silk into delicate blossoms that unfurl when steeped in hot water. The Artisan Tea collection from **Numi Teas** revives a centuries-old Chinese and Indian tradition. Priced from \$14 to \$18, the boxes contain green, white, black, and oolong teas under names such as Jade Ring, Flower Pearl, and Iron Goddess of Mercy. For \$21, Numi also sells a glass teapot that lets you watch the tea leaves transform (numitea.com). —Gerry Kherr...





BY ROBERT BARKER

Suppress Your Appetite For Herbalife

Always a curious company, Herbalife just gets curiouser. The direct-sales marketer of dietary supplements grew like crazy from its founding in 1980 by high school dropout Mark Hughes. Today its Web site still features paeans to Hughes, plus a gallery of his photos. Yet it avoids mentioning the fact that he is long dead.

Strange, unless you sell such items as Relax Now, a jujube, shwagandha, and passionflower combo that Herbalife says eases anxiety and stress. Especially strange since Hughes died in May, 2000, after a four-day alcoholic binge. The coroner found the booze didn't mix well with Doxepin, a prescription antidepressant Hughes had been taking. Nor did Hughes' death with the healthful image he nurtured as Herbalife's spokesman-in-chief. When I asked why Herbalife's site features Hughes yet makes no mention of his passing, a spokeswoman told me the company is staying quiet while regulators review its plan for an initial public offering of stock. Its prospectus does note Hughes' death, but skips over how he died.

That alone is reason enough for investors to do their own digging—right past this deal. But if you're among the morbidly curious, you might want to examine it more closely. Led by Merrill Lynch and Morgan Stanley, the IPO is estimated to come at \$15.50 a share, raising some \$225 million. In a flurry of transfers, most of that will go to Herbalife's owners, a pair of private-equity funds, Whitney & Co. and Golden Gate Capital. Some will repay part of what the company borrowed when Whitney and Golden Gate took it private in July, 2002. None will go to the benefit of investors, who stand to get 22% of Herbalife at the IPO.

How is Herbalife doing under its new owners? In some ways, better. Sales in 2002 were 1.1 billion. In the last four quarters, they reached nearly \$1.3 billion. Net income, however, has only edged up, to \$24 million in the last year from \$23



VEXING EXIT Founder Hughes's death didn't fit the healthful image Herbalife cultivated

million in 2002. Despite rebrandings and new formulations for some diet supplements—the company eliminated appetite-suppressant ephedra in 2002 and cut back on another, citrus aurantium, this year—Herbalife also depends more than ever on its mainstay, Formula 1 Nutritional Shake Mix. In 2004's first nine months,

Formula 1 delivered 23% of sales, up from 21% in 2002.

To push its products, Herbalife counts on an army of some one million independent distributors in 59 countries. These are the people that Hughes, with a rags-to-riches story of launching Herbalife from his car's trunk, proved so talented at firing up. But it's hardly steadily remunerative work, as the churn in Herbalife's ranks attests. At the last annual count, nearly 100% of distributors below the level of supervisor had turned over, as did 71% of the 191,000 supervisors.

So recruitment and inspiration remain vital to Herbalife. That's now the job of CEO Michael Johnson, who comes to it with a background different from Hughes's. After 17 years at Walt Disney, Johnson joined Herbalife in April, 2003, with a grant of nearly 3 million stock options. In his first year, his salary and bonus totaled \$2.2 million. Is that a big nut for a \$1.3 billion company? Yes. At Avon (2003 sales, \$6.8 billion), CEO Andrea Jung last year received \$2.5 million in salary and bonus, or 0.2% of operating income. Johnson's annual take came to more than 2% of Herbalife's 2003 operating income.

Herbalife is daring to go public at an equity value of more than \$1 billion. That, plus its debt, would give the company a total buyout value near \$1.3 billion, or one times 2004 sales. In 2002, Whitney and Golden Gate paid \$652 million, or 0.6 times sales. I wonder what investors would pay if Herbalife's prospectus came with a copy of Hughes's autopsy report (Los Angeles County Coroner, Case No. 2000-03682). ■

E-mail: rb@businessweek.com

Herbalife's Vital Signs

Revenue	\$1,268
Operating Income	\$123
Net Income	\$24
Net Debt	\$337
Indicated Equity Value	\$1,022
Symbol*	HLF

Dollars in millions, income statement data for 12 months ended Sept. 30, 2004, net debt as of that date
* Tentative

Data: Company reports



BY GENE G. MARCIAL

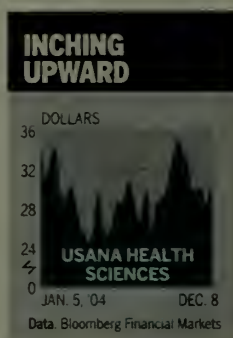
VITAMIN SALES HAVE REBOUNDED FOR **USANA HEALTH SCIENCES**.

AS THE RECOVERY REVS UP, **INGERSOLL-RAND** IS READY TO ROAR.

SIPEX, WITH ITS CEO GONE, SEEMS POISED FOR RAPID CHANGES.

A Ruddy Glow at USANA

WHEN USANA Health Sciences (USNA) fell to the low 20s in April, Jason Schrotberger of Turner Investment Partners snapped up shares—convinced that demand for its nutritional supplements would ramp up. He was right: The stock popped to 35 in October as sales of its products—including adult vitamins with Mega Antioxidant—jumped. USANA also makes skin products, accounting for 15% of sales. Scott Van Winkle of investment bank Adams Harkness, which has done business with USANA, notes that USANA, like Avon Products, hires “associates” to sell direct to customers. Van Winkle, who rates the stock, now at 30.50, a buy, sees 2004 revenue growth of 35%, to \$269 million, and earnings of \$1.46 a share. For 2005, he expects \$308.5 million and \$1.80. Van Winkle is upbeat on USANA’s reformulated skin-care product, Sensé, which will be marketed as being free of harmful chemicals. When it launches in 2005, he expects sales to rocket. (His 2005 earnings figure doesn’t include Sensé.) Turner’s Schrotberger sees higher 2005 earnings—of \$1.85 to \$1.90 a share. For 2006, he forecasts \$2.50, which includes projected Sensé sales. His price target: 40 to 45 in 2005 and 60 in 2006.



Ingersoll-Rand: 'A Snappy Play'

WITH THE ECONOMY expected to rev up in 2005, some investors are turning to Ingersoll-Rand (IR), a heavy manufacturer. “Ingersoll is no longer seen as a boring industrial company. It’s a snappy play on the improving economy,” says Lewis Rabinowitz, vice-president/portfolio manager at C.E. Unterberg, Towbin, which has bought shares. IR has risen from 62 in August to 75.73 on Dec. 8. Rabinowitz says IR’s products—including the Bobcat skid steer loader and Thermo King refrigeration for trucks—position it to profit from a rebound. Rabinowitz figures Ingersoll will earn \$4.95 a share



RABINOWITZ Hop on

in 2004, \$6 in 2005, and \$7.10 in 2006. His 12-month price target: 90. With its cash from selling assets in the past two years, IR aims to buy back 10 million shares. Also, analysts expect Ingersoll to buy CISA, an Italian lockmaker with 10 factories worldwide. It already owns 30%. The rest is valued at \$240 million, plus debt of \$200 million. Andrew Casey of Prudential Equity Group, who tags IR “overweight,” says CISA will lift 2005 earnings by 8¢ to 10¢ a share.

Suddenly, Sipex Looks Ripe for a Buyout

SIPEX (SIPX) IS A PROMISING TURNAROUND play in semiconductors—and a likely takeover bet, too. So say some pros who have been buying shares on rumors that the abrupt Dec. 7 departure of CEO Walid Maghribi moves Sipex closer to being bought out. Sipex makes integrated circuits for manufacturers in the computer and telecom industries. Sipex says Maghribi quit after a disagreement with the board on strategy. “Future Electronics [a Canadian distributor of electronic components in 35 countries], which owns 48% of Sipex, wants to scrap a standstill pact so it can raise its stake,” says one big investor who didn’t want to be named. The idea, he adds, is to turn Sipex around and then sell it. Sipex has been losing money since 2001, and its stock has been on the skids—from 9.41 on Jan. 16 to 4.62 now. In a buyout, the stock is worth 10, says the investor. Robert Adams of Adams Harkness agrees the resignation could pave the way for more aggressive measures—and could clear the way for a sale of Sipex. “We believe any such action would be a positive move for the shares,” says Adams. Sipex, he adds, remains “a hopeful turnaround story.” Sipex’ optical storage device is a key component in the new generation of DVDs that will come out in 2005. And Sipex interim CEO Douglas McBurnie says the storage device will boost revenues substantially. He denies any plans to sell Sipex. ■

STOCK ON THE SKIDS



BusinessWeek online Gene Marcial’s Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine’s publication day, usually Thursdays.

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nk of them as a reprieve from the world around you. Whether it's the engine roar on airplanes, noise of the city, bustle in the office or the blare of neighborhood yard work, these headphones help you escape them all. And they do it with the flick of a switch. You savor delicate musical nuances in places where you couldn't before. And when you're not listening to music, you can use them to quietly enjoy little peace. Clearly, Bose QuietComfort® 2 headphones are ordinary headphones. It's no exaggeration to say you're one of those things you have to experience to believe.

duce noise with Bose technology. David Carnoy reports on CNET that original noise-reducing headphones "set the gold standard." And according to respected columnist Rich Warren, our newest headphones "improve perfection." They electronically identify and reduce noise while faithfully preserving the music, movie dialogue or tranquility that you desire. As Jonathan Takiff reports in the *Philadelphia Daily News*, "Even in the busiest environment, wearing these phones creates a calming, quiet zone for easy listening or snoozing."

oy your music with our best headphone sound quality ever. After trying QuietComfort® 2 headphones, audio critic Wayne Thompson reports that "Bose engineers have made major improvements." The sound is so clear, you may find yourself discovering new subtleties in your music. CNET says all sorts of music – classical, rock, and jazz – sounded refined and natural."

"The QuietComfort 2 lives up to its name, enveloping you in blissful sound in the utmost comfort. It's easy to forget they're on your head." That's what columnist Rich Warren says. And as Ivan Berger reports in *The New York Times*, the "QuietComfort 2

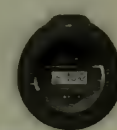
offers more conveniences than the original model." You can wear them without the audio cord to reduce noise. Or, attach the cord and connect them to a portable CD/DVD/MP3 player, home stereo, computer or in-flight entertainment system. When you're done, their convenient fold-flat design allows for easy storage in the slim carrying case.



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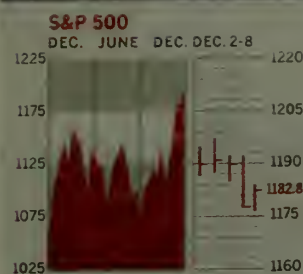
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Personal Business Figures of the Week

STOCKS



COMMENTARY

Equities were headed higher until the sudden drop in oil prices on Dec. 7. And while Main Street may have been relieved by the decline, Wall Street had the opposite reaction, sending stocks sharply lower, a response suggesting a bad bet by hedge-fund investors. Stocks made up some of the losses the next day as Merck and GE rose. The damage, though, had been done.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN WEEK ENDED DEC. 7



52-WEEK TOTAL RETURN WEEK ENDED DEC. 7



Data: Standard & Poor's

U.S. MARKETS

	DEC. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1182.8	-0.7	6.4	10.6
Dow Jones Industrials	10,494.2	-0.9	0.4	5.3
NASDAQ Composite	2126.1	-0.6	6.1	9.1
S&P MidCap 400	637.7	-1.2	10.7	12.5
S&P SmallCap 600	318.2	-2.5	17.7	20.2
DJ Wilshire 5000	11,623.6	-0.8	7.6	11.5

SECTORS

	DEC. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
BusinessWeek 50*	690.0	-0.6	10.9	13.9
BW Info Tech 100**	365.6	0.0	4.3	8.2
S&P/BARRA Growth	571.5	-0.2	2.8	6.2
S&P/BARRA Value	606.9	-1.2	10.0	15.1
S&P Energy	281.4	-2.9	25.5	36.3
S&P Financials	399.4	-0.8	5.1	8.9
S&P REIT	141.7	-0.1	22.4	23.8
S&P Transportation	240.8	0.8	19.3	21.5
S&P Utilities	135.9	-1.0	14.8	20.0
GSTI Internet	166.7	-0.1	15.2	25.8
PSE Technology	764.7	-0.6	9.7	13.5

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	DEC. 8	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1359.4*	1.1	15.3	2.1
London (FT-SE 100)	4703.9	-0.7	5.1	1.1
Paris (CAC 40)	3775.0	-0.6	6.1	1.1
Frankfurt (DAX)	4201.4	0.4	6.0	1.1
Tokyo (NIKKEI 225)	10,941.4	1.5	2.5	1.1
Hong Kong (Hang Seng)	14,022.3	-1.0	11.5	1.1
Toronto (S&P/TSX Composite)	9003.7	-0.7	9.5	1.1
Mexico City (IPC)	12,113.6	-1.0	37.7	4.1

FUNDAMENTALS

	DEC. 7	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.95%	1.96%	1.63%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.8	19.8	26.7
S&P 500 P/E Ratio (Next 12 mos.)*	16.6	16.4	17.8
First Call Earnings Revision*	-0.21%	-0.19%	-0.35%

*First Call Corp.

TECHNICAL INDICATORS

	DEC. 7	WEEK AGO	READING
S&P 500 200-day average	1123.4	1122.4	Positive
Stocks above 200-day average	74.0%	75.0%	Negative
Options: Put/call ratio	0.62	0.63	Neutral
Insiders: Vickers NYSE Sell/buy ratio	6.26	5.73	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Constr. & Engineering	22.1	Internet Retail	105.6
Fertilizers & Ag. Chems.	13.7	Steel	74.3
Managed Health Care	12.4	Internet Software	73.0
Comptr. Stge. & Perphs.	11.8	Fertilizers & Ag. Chems.	72.6
Internet Retail	10.6	Wireless Services	63.4

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Gold Mining	-8.6	IT Consulting	-37.1
Hypermkts. & Suprcntrs.	-6.5	Insurance Brokers	-26.1
Specialty Appar. Retailers	-6.4	Semiconductor Equip.	-21.1
Computer Stores	-6.4	Semiconductors	-21.1
Instrumentation	-5.0	Broadcasting	-17.1

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	6.4	Latin America	36.4
Europe	5.7	Natural Resources	32.4
Technology	5.2	Real Estate	30.0
Real Estate	5.1	Communications	28.4
LAGGARDS		LAGGARDS	
Precious Metals	-4.6	Precious Metals	-6.1
Health	0.6	Technology	7.5
Utilities	0.9	Health	8.4
Japan	0.9	Domestic Hybrid	8.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Apex Mid Cap Growth	14.8	ProFds. Wriss. Ultsr. Inv.	83.5
Oppenheimer Gbl. Opps. A	14.4	iShares MSCI Austria Idx.	72.4
Oberweis Micro Cap	12.2	ProFunds Energy Ustr. Inv.	54.5
iShares MSCI Austria Idx.	12.1	U.S. Gbl. Accde. E. Erpn.	54.2
LAGGARDS		LAGGARDS	
Oppenheimer Real Asst. A	-9.3	Ameritor Investment	-35.3
ING Russia A	-9.3	Thurlo Growth	-34.2
PFds. Pr. Mtls. Ustr. Inv.	-8.9	ProFunds UltSh. OTC Inv	-30.5
Rydex Precious Metals	-8.6	Rydex Dyn. Vent. 100 H	-30.5

INTEREST RATES

KEY RATES

	DEC. 8	WEEK AGO	YEAR AGO
Money Market Funds	1.56%	1.50%	0.6%
90-Day Treasury Bills	2.24	2.21	0.90
2-Year Treasury Notes	2.90	3.00	1.91
10-Year Treasury Notes	4.12	4.36	4.32
30-Year Treasury Bonds	4.78	5.01	5.15
30-Year Fixed Mortgage †	5.62	5.75	5.81

†BancQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.66%	4.61%
Taxable Equivalent	5.23	6.59
Insured Revenue Bonds	3.83	4.71
Taxable Equivalent	5.47	6.73

THE WEEK AHEAD

RETAIL SALES Monday, Dec. 13, 8:30 a.m. EST » November retail sales probably grew 0.2% for a second straight month. That's based on the median forecast of economists surveyed by Action Economics. Excluding vehicles, sales most likely rose by 0.4%, after an October gain of 0.9%.

INTERNATIONAL TRADE Tuesday, Dec. 14, 8:30 a.m. EST » The October foreign-trade deficit probably widened to \$52.7 billion,

from a \$51.6 billion trade gap for September.

INDUSTRIAL PRODUCTION

Tuesday, Dec. 14, 9:15 a.m. EST » Industrial output probably expanded by 0.4%, and the average operating rate most likely edged up to 77.9%. In October, output climbed 0.7%, and the utilization rate improved to 77.7%.

FOMC MEETING Tuesday, Dec. 14, 2:15 p.m. EST » The Federal Reserve Board's Open

Market Committee will announce any changes to monetary policy. According to Action Economics, economists expect the Fed will hike rates to 2.25%, from 2%.

CONSUMER PRICE INDEX Friday, Dec. 17, 8:30 a.m. EST »

Consumer prices for goods and services are forecast to have edged up 0.1%, after a 0.6% jump in October. Less food and energy, prices probably moved up 0.2% for a second straight period.

The *BusinessWeek* production index edged back to 231.7 for the week ended Nov. 27, an increase of 10.2 from a year ago. Before calculation of the four-week moving average, the index fell to 231.

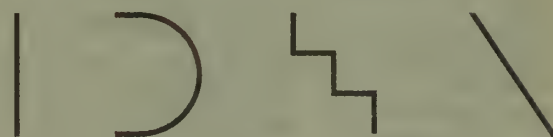
BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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AHEAD

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China's Big Deals: Should We Worry?

THERE'S A WORLDWIDE yard sale going on. Multinational corporations are starting to sell off big-name brands to Chinese companies. IBM is selling its PC business to China's computer-making giant, Lenovo Group. Thomson has unloaded most of its RCA television-manufacturing business through a joint venture with China's TV-making giant, TCL International Holdings Ltd. There's talk in Wall Street mergers-and-acquisitions circles of other big deals, with U.S. corporations shedding major brands. What's going on? Is this a sign of America's economic decline? Should we be worried? Not at all.

A major global reshuffling of assets is under way (page 32). Companies cashing out of their lower-value operations to move upstream to more profitable ones should be applauded. It's the multitude of other large corporations that are sitting on mountains of cash and doing nothing that bothers us. In the U.S., profits are strong and balance sheets are healthy, yet capital spending is subpar at this point in the business cycle compared with previous ones. Most chief executives appear fearful of placing big bets or making bold moves. Nonfinancial corporate liquid assets are at a record \$1.3 trillion, and CEOs are spending much of it buying back

stock and raising dividends. Where's the vision here?

Fortunately, a handful of businesses are showing the way. IBM, for example, is moving out of commodity PC production to focus on high-end services and software. It's part of the general migration in the U.S. away from manufacturing commodity products into higher-value markets with greater

No. U.S. companies are moving upstream and betting on the future

pricing power. IBM, as part of the deal, will get a stake in Lenovo that should improve its opportunities to sell high-margin servers, services, and software to Chinese banks, government agencies, and companies.

IBM is not alone in its product migration. General Electric Co. just sold 60% of its Indian outsourcing operation to a pair of private equity funds. Call centers are fast becoming a low-margin, commodity-service business, and

GE is focusing on its higher-margin medical, energy, and media operations. GE, we should remember, sold RCA to France's Thomson back in 1987, as low-cost Japanese TVs were swamping the U.S. market. Sound familiar?

Chief executives can be pardoned for their defensiveness. We are living through an unusual economic interregnum. A huge cost disequilibrium has opened up inside the global economy and the Internet is making information instantly available everywhere. As a consequence, manufacturing and services are pouring out of America to China and India. It is hard to envision the future. Many CEOs are stuck—waiting for the past to reappear or for evidence of what is to come. But a handful are casting off the past to place bets on the future. A new class of 21st century winners may be in the making.

The New Power Of Brands

IBM'S SALE OF ITS PC division to China's Lenovo Group highlights one of the most distinctive characteristics of current-day capitalism. In a global economy based on commodity production, brand may be a corporation's most important asset. And brand management is an increasingly critical skill for a growing number of businesses around the world.

Chinese companies attempting to break into overseas markets are desperately trying to buy or build global brands. U.S., European, and Japanese companies seeking to move beyond price competition are beginning to rely on the emotional punch that great brands offer to win consumers and maximize margins. Creating a satisfying consumer

experience by focusing not only on price but also on the look and feel of a product or service is the new competitive arena. Companies around the world that get it have an edge over those that don't.

One of the most important things that Lenovo is receiving in its deal with IBM is a lesson in brand management. The thin, black ThinkPad laptop is as much a marketplace icon as Apple Computer's rounded, friendly iMac. Designed by Richard Sapper and marketed as a high-quality, powerful, expensive machine, the ThinkPad has been carefully nurtured by IBM. Some 15 million have been sold since the computer was introduced a decade ago.

Through its deal with IBM, Lenovo will attempt to learn how to create and manage this kind of elite brand. Other Asian companies, such as China's Haier and South Korea's Samsung Electronics, are taking another tack by trying to build their own global brands organically.

In the end, brand is all about culture. As prices fall for virtually all commoditized, manufactured goods, the real competition will be in winning the hearts and minds of consumers. Intellectual property lies more and more in a company's knowledge base of consumer tastes and preferences, not in chemical formulas or technology per se. Welcome to the world of tomorrow.

BusinessWeek

27, 2004 / JANUARY 3, 2005

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Where To Invest

Special Double Issue

05

- » **The Economy: Five Wild Cards for 2005**
- » **What Bush's Plans Mean for Your Portfolio**
- » **Protect Yourself From a Housing Slump**
- » **The Four Hottest Global Plays**
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FUNCTION IS



Invisible IBM infrastructure at the newly renovated Museum of Modern Art is setting the stage for a revolution in the ways the museum's collection can be shared with the public.

FLEXIBLE GALLERIES

Art is impossible to predict; it thrives on the unexpected. That's why MoMA's new infrastructure was designed to serve the infinite possibilities of art that doesn't even exist yet. Built-in flexibility means the museum will be ready to accommodate whatever comes its way.

INVISIBLE TOUR GUIDES

MoMA is currently offering pilot architectural tours of the new building on specially designed PDAs. The technology may soon be in place to include customizable tours based on a visitor's specific interests, as well as a seamless experience between the museum and home. A visitor might be able to bookmark a piece of art on the PDA and then log on to moma.org from home to learn more about it.

TALKING PAINTINGS

Embedded RFID tags are being explored to enable the museum to wirelessly track artworks as they move between the warehouse and the gallery floor. These tags might someday be used to broadcast in-depth information about each work to the viewer's own cell phone or PDA.

MoMA IS ON

Flexible. In depth. On demand. The museum of the future is coming. Get a behind-the-scenes look at MoMA and IBM's partnership at ibm.com/ondemand/moma

ON DEMAND BUSINESS™



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FORM IS



ON



THE PLEASURE NEURO LUXURY MAY BE HABIT-FORMING AND WE HAVE THE MRIs TO PROVE



It doesn't take a brain surgeon to appreciate the immaculate cabin, sensuous heated and cooled front seats and THX® Certified Audio System available in the Lincoln LS. Or does it?

Brains are beautiful. Usually a reference to intellect, but for Dr. Hyde, M.D., neurosurgeon, the brain's physical contours are enthralling. "The anatomy is so beautiful. I just find it a turn of mind."

Her brain is turned on by...well, brains and other finer things. After surgery that starts before dawn, Dr. Hyde may head out for lunch and shopping. En route, Lincoln LS provides stimulation for all the senses. Its heated and cooled* leather-trimmed front seats are pleasing to the touch year-round. A reflex-quick aluminum suspension keeps the ride smooth and steady. The clarity of the THX® Certified Audio System* helps induce a harmonious state, no matter how snarled the traffic. And its cabin, trimmed in American walnut burl* and satin nickel, flashes through the mind like a nerve and stimulates the occipital cortex. Pleasure is registered.

The reaction? "I love this car." Dopamine is released, producing a feeling of well-being. Dr. Hyde adds, "Current research suggests that the nucleus accumbens is very important in pleasure. It's in the limbic cortex, where cognitive thought occurs. It's deeper in the brain where feeling is."

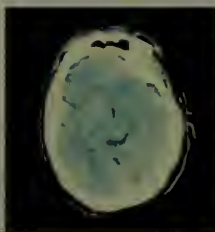
Thus, it's possible luxury may be perceived before it reaches the limbic cortex—before you can "think" it, you are already enjoying it and craving more. "There's so much going on neurally that it's conceivable that we never experience the same thing the same way twice."

The brain: mind-boggling. But whatever mysteries that lie within its folds, there's no better stimulation for the brain of a driver than the empty road, a full tank of fuel and energizing music over the stereo system. But be aware: the pleasures of the road are extremely habit-forming. Go online for an inside view of all the ways Lincoln LS has been designed to tickle your neurons.

lincoln.com

TRAVEL WE

*Available feature.



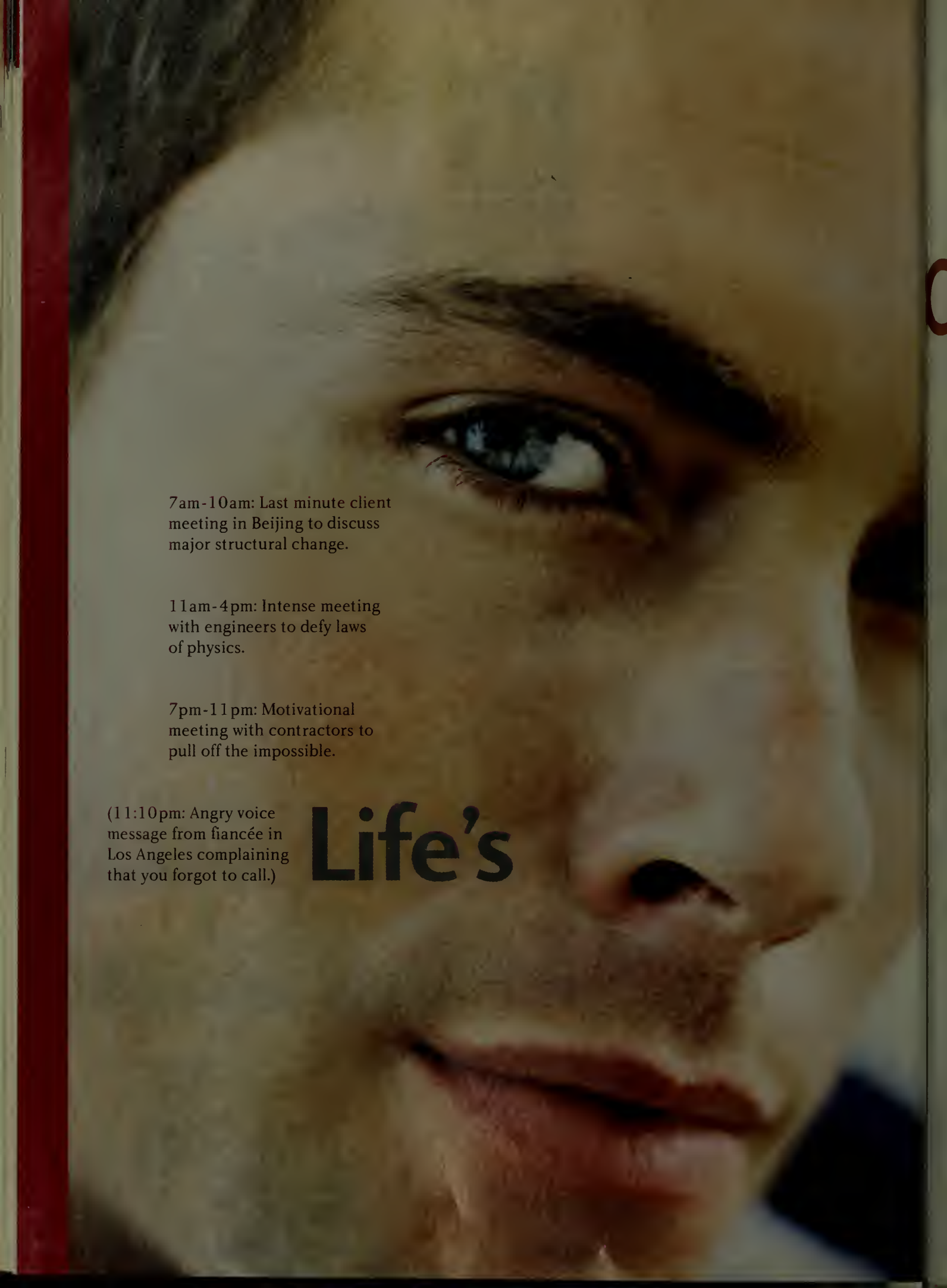
The brain may be the most complex object in the universe. Deserving of all the myriad stimulation the Lincoln LS can provide.

"You can't get more vital than the brain. Where we see and feel and touch and love and hate and experience all of life."

Dr. Deborah Hyde, neurosurgeon



LINCOLN



7am-10am: Last minute client meeting in Beijing to discuss major structural change.

11am-4pm: Intense meeting with engineers to defy laws of physics.

7pm-11pm: Motivational meeting with contractors to pull off the impossible.

(11:10pm: Angry voice message from fiancée in Los Angeles complaining that you forgot to call.)

Life's

(11:15pm: Call to fiancée to show
her you never stopped thinking
about her for a second.)

Good

The LG 3G Phone enables you to
see and talk to someone in real time.
When you need to most.

It's just one way LG makes
life good. To see more ways,
visit www.lge.com





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GERONIMO!

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A Hurting Greenback Pains the World

The weak dollar threatens the globe more than it does the U.S., which would enjoy rising exports and slower growth in the trade deficit, according to Standard & Poor's Chief Economist David Wyss



OPEC's Preemptive Shot

With oil stocks building and prices sliding in recent weeks, the cartel quickly cut back its official quotas to prove it can maintain control of the market. But trimming production before the full force of winter hits the Northern hemisphere is a risky gambit

An Old-Fashioned Prescription for Doctors

Tired of the pressures of conveyor-belt medicine, a growing number of disenchanted physicians are finding a viable market—and better results—in a long-neglected practice: House calls



Housing: Growth's Shaky Foundation?

The booming market has played a big role in keeping the economy moving. But rising rates could soon weigh down home prices, shrinking consumer spending and economic expansion, UCLA's Anderson Forecast warns

The Cell-Phone Directory: No Need to Be Yellow

Despite the worries, the new directory-assistance service for wireless numbers promises to be plenty secure to protect privacy and foil telemarketers



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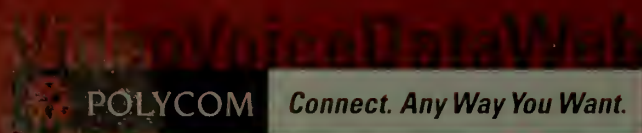
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JP

Front

"We think it's
a new world.
Hostile takeovers
can work."

—Larry Ellison, Oracle CEO,
after PeopleSoft acquiesced
to his company's hostile bid
following an 18-month fight

EDITED BY IRA SAGER

MEDIA WATCH ALL THE NEWS YOU SEE IT TO WRITE

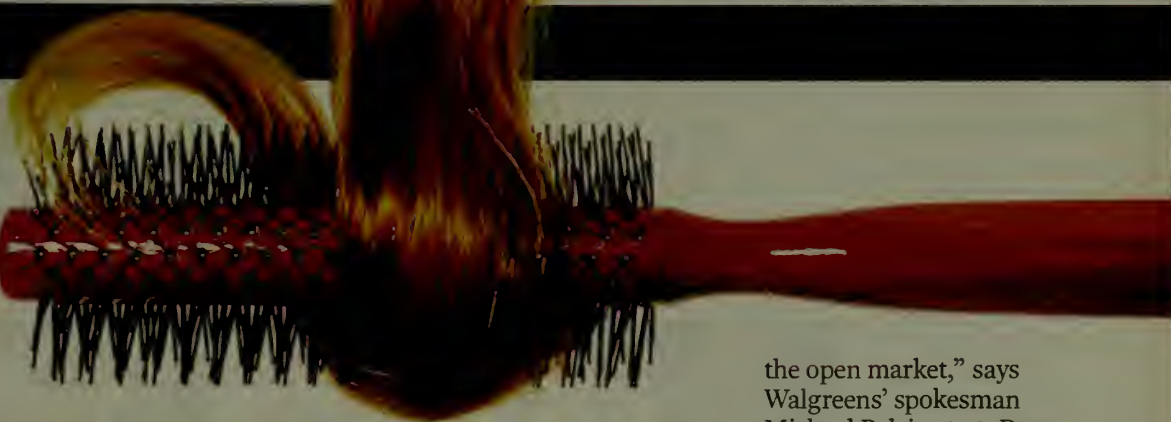
DON'T LIKE what you read in the news? Write it yourself. That's the premise behind Wikinews (en.wikinews.org), an experimental free news site launched in December. Based on collaborative Web software called wiki, it lets anyone submit original or unmarized articles, or come in on a posted story. It's the latest attempt at



at some call "citizen's media." The key difference between Wikinews and other Web news outlets, such as blogs: The articles must be judged objective by a reader review and can be removed. As Jimmy Wales, director of the site's backer Wikimedia Foundation, said: "Let's go back to the fundamentals of good journalism."

Challenges abound, from a review process still in flux to issues of libel and copyright. It may take a while for citizen reporters to rewrite the news business.

—Robert D. Hof



CURL UP AND DYE

Will They Get The Gray Out?

AT A SEATTLE Rite Aid, there's a wide selection of hair-care products from Nexxus, Paul Mitchell, Redken, Rusk, and Sebastian. Across the country, a Duane Reade in Manhattan has just as ample a supply. Trouble is, these products are intended for sale only through salons.

A six-week investigation by *BusinessWeek* found a thriving gray market in professional-grade hair-care goods. A spot check of retailers nationwide—including CVS, Duane Reade, Eckerd, Rite Aid, Target, and Walgreens—found many items marked "for salon sale only."

Makers of salon-only products allege retailers are selling goods that have been improperly

diverted. Up to \$800 million of the industry's \$29 billion yearly product sales may be diverted or counterfeit, says Steve Sleeper, executive director of the Professional Beauty Assn. He says sales of such bogus goods are growing at nearly twice the industry's 3% annual rate.

How do retailers get hold of the goods? They buy from wholesalers, who obtain the items from "collectors." These individuals buy the products from salons, possibly in violation of their exclusive sales contracts with manufacturers, offering a quick 20% profit over salons' costs.

No law prohibits retailers from selling a salon product. "Each is readily available and purchased legally on

the open market," says Walgreens' spokesman Michael Polzin. CVS, Duane Reade, Target, and Eckerd also say they use legal sources. Rite Aid did not return calls.

Manufacturers argue that consumers are at risk. Makers can't recall items or guard against counterfeit products. But the big issue is brand erosion: Companies build their reputations through exclusivity—setting high prices because their products are sold only by professionals. If they can be found alongside Alberto VO5 and Pantene, what sets them apart from cheaper rivals?

It's an issue manufacturers can't ignore. John Paul Mitchell Systems has launched a multi-million-dollar ad campaign urging users to stick to salons for the real thing. Instead of product ads, "we're spending that money educating consumers," says CEO John Paul DeJoria. The alternative? More sales down the drain.

—Ann Therese Palmer, with Jessi Hempel and bureau reports

For more, go to businessweek.com



FAT WALLETS

ANOTHER STELLAR YEAR FOR HONCHOS

RANK-AND-FILE employees are expected to get record low pay increases for 2004—an average of 3.3%, says human-resources consultant **Hewitt Associates**. But not so for the nation's chief executives. A study of 68 companies that already have filed proxies found that the median increase was 8.8%, bringing overall pay packages to nearly \$7.3 million. That's up from a 5.2% hike in 2003.



CEO SCOTT
Richly rewarded

Pay consultant **Equilar** found that median option grants fell 19%, to \$3.2 million, as companies prepared for option expensing in 2005. But median base salaries rose 4.1%, to

\$908,269; bonuses climbed 32.6%, to \$975,000; stock grants grew by 34%, to \$2.7 million; and long-term incentives jumped 72.1%, to \$773,719.

Among the highest paid: H. Lee Scott Jr., CEO of **Wal-Mart Stores**. He took a 20% cut in total pay in fiscal 2004—and still walked away with nearly \$23 million, including a \$4.2 million bonus, a \$6.7 million restricted stock award, and options valued at \$10.5 million, according to Wal-Mart's proxy. The company says Scott earned his bonus by meeting goals for pretax profit, but declined additional comment.

For corporate honchos, "it's going to be another good year," says **Mercer Human Resource Consulting's** Steve Sabow. Some things never change.

—Louis Lavelle

TURKEY TALK

SCROOGED The Internal Revenue Service could spoil the holiday supper. Many companies used to dole out turkeys this time of year. Now, says publisher Bureau of National Affairs, 41% give out coupons, which can be redeemed at any store for a turkey or whatever else an employee wants. But the **IRS** recently judged that gift certificates, unlike actual birds, are a cash equivalent—and thus taxable. That'll be a deterrent to seasonal giving, says Washington tax attorney David Fuller, though more specific certificates may avoid cash equivalency. Still, seems a Grinchy thing to tax turkeys for workers. But those 50-yard line NFL seats for execs—still tax-exempt.

—Brian Hind



MOBILE MEDIA

WHAT ARE YOU WATCHING ON YOUR CELL?

READY FOR mobile TV? In January, **Fox** will introduce one-minute "mobisodes," based on its hit show **24**, for **Vodafone** cell-phone users in most of Europe. A few months later the TV series is expected to be on phones of Vodafone's U.S. partner, **Verizon Wireless**.

The mobisodes, tailored for small screens with more closeups and larger text, won't likely offset falling network ratings. But as folks spend more time away from home, TV execs are eager to lure eyeballs. It's Hollywood's first made-for-cell show, but Fox says deals with other carriers are coming.

—Ronald Grover

DRAWN & QUARTERED



The Patriots

SO THIS YEAR, TO HELP OUT THE NATION WITH THE TRADE DEFICIT, WE DECIDED WE'RE NOT GOING TO BUY ANYTHING MADE IN CHINA...

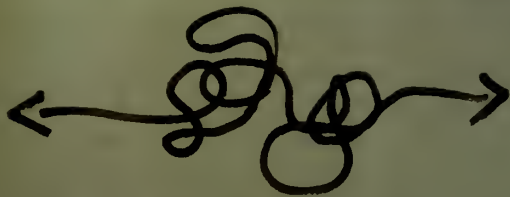
... WE'RE JUST GOING TO GIVE GIFTS MADE IN THE GOOD OLD U.S.A.



DANZIGER
NYTSKWS Dec 8 2004



UPS can help you shorten your supply chain. For a technical explanation, see figures A. and B.



A. BEFORE BROWN



B. AFTER BROWN

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FACE TIME

MICHAEL PORTER



INNER CITIES ARE WHERE THE MONEY IS

Harvard professor **Michael Porter** is an unlikely champion of inner cities. Author of the B-school text on strategy, he seems more boardroom than bodega. But the nonprofit he founded in 1994 uses economic data to dispel myths about urban neighborhoods to attract corporate investment. A new study by his Initiative for a Competitive Inner City says that retail spending in densely populated urban areas is \$25 million per square mile, compared with \$3 million in metro areas.

How did Porter, 57, come to this cause? After the 1992 Los Angeles riots he saw officials try to craft social policies to ease tensions caused by poverty. But Porter thought "the effort was not based on sound economic principles."

Porter's message is getting through: Home Depot has some of its best sales at its new store in Boston's Dorchester. Next, he hopes to dispel more myths with a list of the top 10 cities with urban economies outpacing the overall city.

—*Jessi Hempel*

HAPPY HOLIDAZE

DEAR SANTA: THE WORD ON THE STREET

VIDEO-GAME MAKERS are in for some extra-happy holidays this season. How do we know? We went right to the Big Man himself. From the **Hillsdale Shopping Center** in San Mateo, Calif., to Atlanta's **Lenox Square Mall** to the **Roosevelt Field Mall** in Garden City, N.Y., *BusinessWeek's* newsmakers have once again braved throngs of shoppers to ask Santa Claus's reps which goods are topping kids' wish lists this year.

The Santas report that boys are asking for **Sony's PlayStation 2**, **Nintendo DS**, **Microsoft's Xbox**, and myriad games for those consoles. Spider-Man and Power Rangers are still in demand. For younger boys, Thomas the Tank Engine is tops.



D.C. FOLLIES

PRESTO! MORE CASH FOR THE PENTAGON

IT APPEARS that House Armed Services Committee Chairman Duncan Hunter can get away with accounting tricks that could land a CFO in hot water. In the recently passed defense authorization bill, Hunter boosted military spending without raising the Pentagon's budget. How? When the California Republican cut accrued expenses for retiree health benefits—what



PLYMOUTH MEETING, PA.



DALLAS



ATLANTA



SAN MATEO, CALIF.



WILLOW GROVE, PA.



GARDEN CITY, N.Y.

New this year, several Santas say girls want video games, too. Barbie continues to be the most sought-after doll, followed by Bratz and the American Girl and Dora the Explorer collections. Also in the mix: traditional games and dolls from Candy Land to Cabbage Patch Kids.

The little ones are ever more efficient with their increasingly lengthy requests. A practical Texas child brought Dallas Santa Cecil Ethridge, 61, a catalog with dozens of pages neatly earmarked.

The real Santa Claus—you

can check his driver's license where his birthdate reads 439 A.D.—works the **Willow Grove Park Mall** in Willow Grove, Pa. He has noticed that children's lists have gotten almost as long as his beard. But it's not that kids have gotten greedier, he says. It's just that parents are wealthier. "Kids are taking advantage of that to ask for more," says Claus.

Not all have material requests: A Dallas child asked for an end to the war in Iraq. Of course some things even Santa can't fix. —*Jessi Hempel* with bureau report

THE STAT

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The percentage of people aged 35 to 44 who admit to having "regifted" presents. Seem small? A quarter of the people in that age range noted that they would lie about it.

Data: DHL Caravan Opinion Research

the Pentagon will owe down the road—it worked like legislative legerdemain. Presto—\$12 billion available now

for such items as surviving spouses' benefits and privatizing military housing.

Auditors would never let a company do that. "I don't know how you would get away with it," says analyst Dan Mahoney of the **Center for Financial Research & Analysis**, an independent watchdog group.

Hunter argues that Uncle Sam is good for the money: "Nobody's saying we're not going to pay the bill. The question is whether it comes from Treasury or Defense." In Washington, there's no penalty for ignoring fiscal prudence.

—*Stan Crook*

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CELEBRATING

75

As part of its anniversary celebration, BusinessWeek is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. For profiles of all the innovators we've published so far, and more, go to www.businessweek.com/innovators/

Information at Warp Speed

IN 1999, WHEN NET mania had reached an unbridled frenzy of sock puppets and paper millionaires, a pair of unknown computer scientists often stayed up late pondering *Star Trek*. Larry Page and Sergey Brin, who had dropped out of Stanford University's computer-science PhD program to found a little-known

search company in Palo Alto, Calif., mused about building a tool like the USS Enterprise's omniscient computer. The all-knowing voice would always deliver the precise answer to any question in a fraction of a second.

What started out as youthful daydreaming has blossomed over the past half-decade into a 3,000-person company that's changing the world of information. Channeling the knowledge in billions of Web pages through its simple-to-use site, Google has put acres of information at its users' fingertips. Instantly offering insight into information on anything from cold symptoms to potential blind dates, the search giant has spawned an Internet phenomenon, with 650 million searches each day. At the same time, its ability to pinpoint people looking for "Chicago locksmith" or "Caribbean vacation" has advertisers flocking to the Web.

Page and Brin, both 31, were unlikely candidates to transform the budding Net field. For starters, Yahoo! Inc. had established itself as the first widely popular search engine in 1995—while Page and Brin were just getting acquainted at Stanford. In addition, the two headstrong engineers didn't exactly hit it off. "When Sergey and I met, we both thought the other was really obnoxious," Page told *BusinessWeek* earlier this year.

But as the duo began collaborating, they saw huge opportunities in improving the search experience. Early search engines, which sorted pages by analyzing words and their positions within a document, were quickly proving inadequate as the Web expanded. Page and Brin were convinced that the links connecting billions of Web sites could provide an answer.

With Google, Page and Brin turned Web search into a giant popularity contest

Just as the success of a patent often is measured by the number of times it's cited by other patents, Page and Brin felt that a Web page pointed to by 500 different sites would be more valuable than one with just five incoming links. Simply put: They turned Web searches into a giant popularity contest.

Although Page and Brin weren't the first to ponder this solution, they were the first to crack the computing and math challenges behind such link analysis. They built a precursor to Google, powered out of Page's Stanford dorm room. After shopping the technology around and finding no takers, Page and Brin set up shop in a friend's garage in mid-1998.

Although the Google founders were sure their technology was a quantum leap forward, they had no clue how to turn it into a business. Initially they scorned the notion of accepting ads. But after a competitor began selling ads around search results for sizable profits, Google followed suit. Its superior technology brought in hordes of users, igniting ad sales. Today Google is a \$2 billion advertising juggernaut, with marketers clamoring to nestle their ads alongside its search results.

With success has come plenty of challenges. Google's stock has doubled, to \$170, since its August initial public offering. That price reflects tall expectations, particularly with Yahoo and Microsoft Corp. charging ahead in search. Regardless of how Google fares, however, its founders' innovation is clear. We can find out more, and find it more easily, than ever before. ■

—By Ben Elg



SEEKING LINKS
Brin and Page

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[You] totally ignore a fundamental change that comes with globalization: The notion of nation is becoming less important."

—John L. Graham
 Irvine, Calif.

TRADING OPINIONS ABOUT FREE TRADE

YOUR ARTICLES "The China price," "How to level the playing field," and "Shaking up trade theory" (Special Report, Dec. 6) totally ignore a fundamental change that comes with globalization: The notion of nation is becoming less important. Economic analyses that turn on "national" performance or competitiveness are inadequate for current trends. Units of analysis that are taking on new importance are regions such as the European Union, NAFTA, even the Mekong River valley.

—John L. Graham
 University of California
 Irvine, Calif.

"SHAKING UP trade theory" has some interesting points but reflects confusions in the public debate rather than dissensions in trade theory. The [Paul A.] Samuelson paper is not about offshoring of services through the Internet or other mediums, which created a panic wave, but really about a different and indeed conventional question that has recurred for half a century: Can changes such as productivity increases outside the U.S. hurt the U.S.?

Thus, imagine that you are exporting aircraft, and new producers of aircraft emerge abroad. That will lower the price of your aircraft, and your gains from trade will diminish. You have to be naive to believe that this can never happen. But you have to be even more naive to think that the policy response to the reduced gain from trade is to give up the remaining gains as well.

The critical policy question we must address is: When external developments such as the growth of skills in China and India, for instance, do diminish the gain from trade to the U.S., is the harm to the U.S. going to be reduced or increased if the U.S. turns into Fortress America? The answer is: The U.S. will only increase its anguish if it closes its markets. Even a trade economist understands this.

—Jagdish Bhagwati
 Arvind Panagariya
 Columbia University
 New York

Editor's note: This letter was also signed by economists Kyle Bagwell (Columbia University), Robert Baldwin (University of Wisconsin), Donald Davis (Columbia University), Avinash Dixit (Princeton University), Ronald Findlay (Columbia), Gene Grossman

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Readers Report

CORRECTIONS & CLARIFICATIONS

In "Tractor plows ahead" (Inside Wall Street, Nov. 29), the ticker symbol for Tractor Supply Co. should read TSCO. And in "Why a suitor may click on theStreet.com," the symbol for theStreet.com Inc. should be TSCM.

The table accompanying "Minimum wage: The states get it" (Social Issues, Nov. 29) should have noted that Maine's minimum wage increased to \$6.35 on Oct. 1 and will rise to \$6.50 on Oct. 1, 2005.

In the table accompanying "The salts of the seas" (Personal Business, Dec. 6), we misspelled Belamandil Flor de Sal, a sea salt from Portugal's Algarve.

Inceton), Douglas Irwin (Dartmouth College), T.N. Srinivasan (Yale University), Robert Staiger (Wisconsin), and David Weinstein (Columbia).

INDUSTRY BUILDS wealth the way manufacturing does, with its layers of added value. By letting China gut American manufacturing by manipulating its currency, dumping goods, and counterfeiting everything that is American, we've come a *papier mâché* economy needed the world only for consumption. There is nothing we can do that the Chinese can't do now at one-tenth the cost, and it paints a bleak future for America.

—Raymond Santilli
Oklahoma City

WAY TO SLOW the outsourcing of U.S. white-collar jobs is to increase the H1-B quotas for white-collar professionals in India and China. The presence of increased H1-B job opportunities will drive Indian and Chinese domestic wages for white-collar professionals from abroad educational institutions. This will increase outsourcing of white-collar jobs in India and China while increasing competition for American workers and increasing U.S. gross domestic product through the economic multiplier effect.

—Arun Khanna
Butler University
Indianapolis

JUL MAGNUSSON'S "How to level the playing field" (Special Report, Dec. 6) points out that the balance-of-trade deficit includes borrowing foreign capital to the tune of \$413 billion, our budget shortfall. The current-account deficit, now headed \$620 billion this year, measures trade

and capital flow, like a bank account. Americans do not save, and they consume more than they make. We are borrowing against our future. Replacing the income tax with a consumption tax is one change that will increase our savings rate, increasing our "bank account" for investment and job creation.

Magnusson also proposed enforcing trade laws more aggressively. The example he used was the semiconductor trade agreement in the mid-1980s. It disadvantaged a much larger segment of industry and increased prices about eightfold overnight to consumers of semiconductors. And it resulted in leaving U.S. companies less competitive and creating large windfall profits to Japanese manufacturers.

—Chris Quackenbush
Miamisburg, Ohio

Editor's note: The writer is former chair of the Silicon Valley Council of the American Electronics Assn.

I PROPOSE A VERSATILE and flexible instrument that can pull this country out of the quicksand of the current-account deficits. It involves the U.S. setting an upper boundary on the allowed annual trade deficit in consumer goods for each country or group of countries. Under my plan, Congress sets annual limits on the trade deficit, and the President allocates the deficit among trading partners. A country may exceed its limit if its government pays to the government of the U.S. a stipulated percentage (up to the full amount) of the excess deficit in consumer goods. Both the number and zeal of customs inspectors dedicated to accepting goods from a country would directly depend on this country's relevant behavior.

—Vladimir A. Masch
Warren, N.J.

WE WILL NEVER reduce or eliminate our trade deficit as long as we continue to export industries instead of the products of industry. As Henry Ford said: "There is one rule for industrialists and that is: Make the best quality of goods possible at the lowest cost possible, paying the highest wages possible."

—Eric Dalton
Germantown, Tenn.

I AM NO economist. I am, however, alarmed by the rapid change in thinking in the States. As a Chinese, I want to share with you some history. The decline of China's power, starting from roughly 1400 onwards, was in large part due to its closed-door, trade-with-none policy. The rise of modern China is due to its open-

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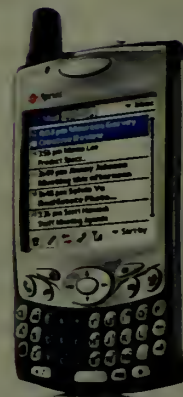
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Readers Report

or, trade-with-all policy. I hope the U.S. learn from this.

—Li Siu-wah
Hong Kong

FIND IT VERY interesting that the abber “How America can meet ‘the China Price’” (Editorials, Dec. 6) says start by cutting the budget deficit. And most funds for education.” Both of these things are exactly what George W. Bush won’t do, and exactly what John F. Kerry said he would do.

—James V. Showalter
San Francisco

READING THIS Special Report, a wave of déjà vu swept over me. All you have to do is dig out your stories from the 1980s and ’90s, change the titles from Japan to China, and reprint them. Not only are the articles the same, but the conclusions are the same.

—Richard Brawer
Ocean, N.J.

CE YOUR EARLIER pieces on outsourcing and our ballooning trade deficit, you have kept on message: We need to “start by cutting the budget deficit. And boost funds for education.” However, we also need to recognize that the stage is set for the advance of a new “Creative Age,” in which creativity and innovation will be the hallmarks of the most successful communities and vibrant economies. In that process we need to engage communities across the nation, and importantly those in each community with responsibilities for education. These communities placing a premium on cultural, ethnic, and artistic diversity, and reinventing their educational systems—from preschool through graduate school—will probably burst with creativity and entrepreneurial fervor.

—John M. Eger
San Diego State University
San Diego

ERE ARE JUST not enough manufacturing jobs to go around in the world, and the U.S. will lose as a result, as it cannot compete with the Chinese and Indian ops. Twenty years from now, the U.S. won’t be holding on to the high-skilled labor market. As Jagdish N. Bhagwati suggests, these jobs will already be gone. This nation is at the forefront of another revolution, transitioning into a completely service-oriented economy with all manufacturing being done overseas. Sometime economists realize that Ricardian comparative advantage theory is

outdated and insufficient to describe the current world economy.

—Michael Abernethy
Pflugerville, Tex.

IF “THE CHINA PRICE” is such a threat to the U.S. economy and business, can you imagine the problem it has created in the other developing and less-developed nations? The undue advantage that the Chinese manufacturers have in terms of the currency and government subsidies should be addressed before the world economy becomes one-sided.

—Mohan Iyer
Hockessin, Del.

IN YOUR REPORTS ON China, there was not one mention of how much more abuse the environment can tolerate. There have to be limits to how much cropland can be consumed for factories and how much air and water pollution the populace can absorb. China is poisoning itself in ways that will be difficult and costly to reverse.

—David Johnson
Chula Vista, Calif.

HOW UNFORTUNATE that we just passed through a Presidential election without considering the implications of our new two-superpower world. Surely the Chinese people’s rise from poverty represents great progress for the world. But this remarkable rise has been largely financed by U.S. investors, for whom low wages and high profits always seem to trump democratic process and national interests. Should not the U.S. government also represent the belief of other Americans that democracy and human rights in both countries are as important as free markets and profits?

—Carl Proper
Lexington, Mass.

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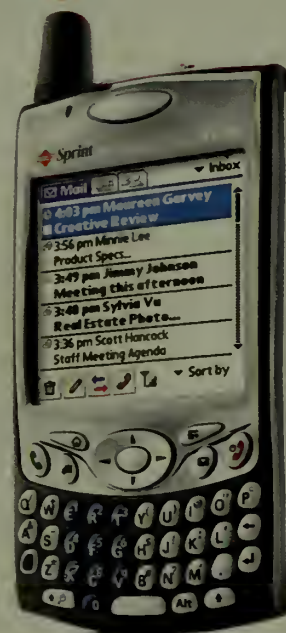
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In a Flash You Just Know

BLINK The Power of Thinking Without Thinking
By Malcolm Gladwell; Little, Brown; 277pp; \$25.95

When they learn that the author of *The Tipping Point* has a new book, many people will make a snap decision to buy it. They may recall Malcolm Gladwell's first effort, with its stimulating explanation of how ideas and trends can turn into "social epidemics." Readers may also know Gladwell's name from his

wide-ranging articles in *The New Yorker*. Such impulse reactions and other instant appraisals come under Gladwell's microscope in *Blink: The Power of Thinking Without Thinking*. The book is concise and provocative, although you may find it tough to glean lessons on how to improve your own hasty judgments.

On-the-spot decision makers, Gladwell shows us, can be astonishingly insightful. For example, he tells of art experts who examine a purported 6th century B.C. Greek *kouros* statue and instinctively know it's a fake. There's the retired Marine who, in a 2002 war game, uses a rogue commander's seat-of-the-pants instinct against process-obsessed officials and succeeds in destroying 16 ships. Gladwell also introduces us to a psychologist who listens to a couple's casual conversation and can tell in minutes that they are probably headed for divorce.

The secret of such abilities, the author says, lies in "thin-slicing," or instantly homing in on a few salient details. For the psychologist, it comes down to a question of contempt: If even one partner displays it toward the other, the marriage is in trouble. Another prescient snap-judge is legendary tennis coach Vic Braden, who can tell before the racket hits the ball if a player is about to double-fault. Braden's predictions, even when they involve athletes he has never met, demonstrate an uncanny accuracy—yet the coach can't explain why. Of course, he has the benefit of a lifetime's immersion in tennis, which has given him insights he may not even recognize. The same gut instinct even applies to more amateur pursuits such as speed dating, in which singles give a thumbs up or down on potential mates in a matter of minutes. Strangers instantly know who attracts them, even if they can't articulate what they're looking for.

Still, not all instant assessments are spot on. The dark side of "thinking without thinking" commands a great deal of the author's attention. He points out that there are times when snap decisions can go horribly wrong. One disastrous example was the 1999 killing of Amadou Diallo in the Bronx. After four undercover cops spotted the Guinean immigrant street peddler outside his apartment taking in some fresh air,

they shot him 41 times. His race, limited English, location in crime-ridden neighborhood, and somewhat panicked reaction to having burly men approach him at midnight led the cops to a series of misjudgments. The police did engage thin-slicing, but they focused on misleading signals, in part, critics say, because of racial prejudice.

Certainly, unconscious bias plays a major role in snap judgments. It's why tall people consistently earn more and rise higher in organizations. It's why orchestras rarely gave key chairs to women until conductors began holding auditions behind partitions. And, Gladwell asserts, it's why Warren G. Harding was elected President when his lack of intelligence and experience would seemingly have disqualified him for the job. Harding, with his booming voice and classic good looks, simply appeared Presidential. "As he grew older, he grew more and more irresistibly distinguished looking," Gladwell writes. Yet Harding proved to be one of the worst U.S. Presidents. Gladwell challenges us to reflect on our own impulses, using several exercises that illustrate how people unconsciously associate certain attributes with physical characteristics. But since many of these tests involve race and gender, areas in which bias is well-documented, the results may not surprise too many readers.

A more enlightening example involves the now-legendary failure of New Coke. In a series of blind taste tests, old Coke's poor showing led the company to launch a product that was closer in taste to the sweeter Pepsi. Coca-Cola executives had assumed that consumers' snap decisions in

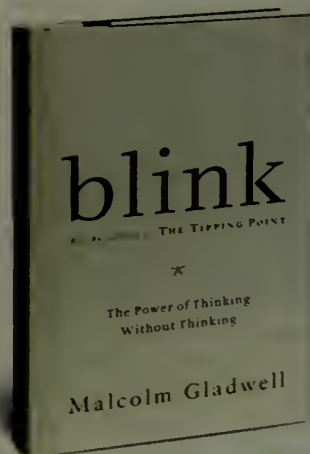
taste tests signaled a lasting preference for Pepsi. They failed to reflect that consumers don't stop drinking after one sip, and that an initially appealing sweetness can grow cloying over the course of a whole can. More important, people do not drink soda blind and many fans had gravitated to the old Coke for its image and brand. In sum, old Coke's

On-the-spot assessments are often astonishingly insightful

appeal depended on far more than its initial taste.

These anecdotes are absorbing, but the lesson Gladwell intends us to draw from them is vague. Those who can filter out the noise of superficial physical characteristics or even their own wishful thinking, he suggests, may be able to make valid choices almost without thought. Otherwise, they could make serious, sometimes fatal, mistakes. *Blink* may leave readers pausing before each decision and then second-guessing every pause. ■

—By Diane Brady





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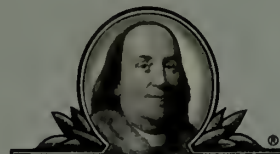
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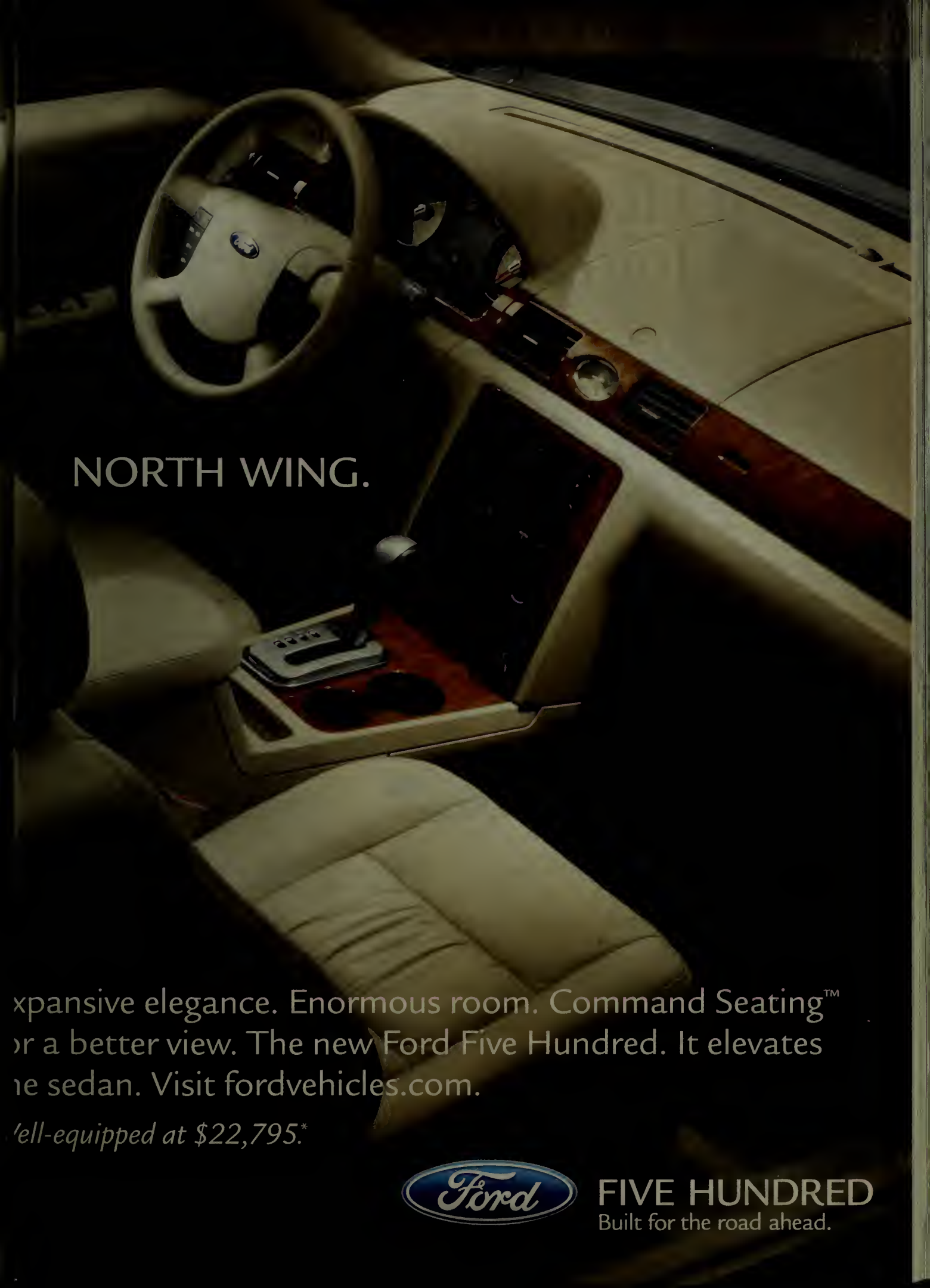
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BWK10/04

A close-up, low-angle shot of a car's interior, focusing on the leather-upholstered front seats and a headrest. The lighting is dim and moody, highlighting the texture of the leather. The text "SOUTH WING." is superimposed in the center.

SOUTH WING.

*2005 Five Hundred SE, as shown. 2005 Five Hundred Limited \$26,795 MSRP, taxes, title and license fees extra.

A high-angle, close-up photograph of the front interior of a Ford Five Hundred. The image shows the driver's side, including the steering wheel with the Ford logo, the dashboard with wood trim, the center console with a gear shifter, and the leather-upholstered front seat. The lighting is warm and focused, highlighting the textures of the leather and wood.

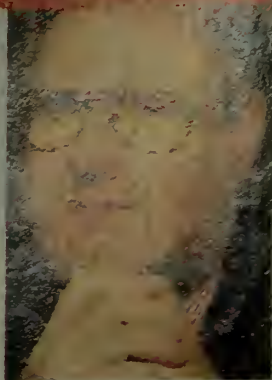
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BY STEPHEN H. WILDSTROM

Hey, Movie Studios—Join the Digital Party

Occasionally we pundits hit the target. A year ago nearly everyone who follows the technology industry predicted that 2004 would be the year that digital entertainment really hit the consumer mainstream. The Apple iPod-driven surge of downloaded music and an explosion of choice in digital televisions, especially oversized flat panels, proved us right.

Looking ahead, 2005 increasingly appears to be the year the entertainment industry will have to decide if it wants to ride this surging tide or continue to fight it. Crucial decisions in coming months will determine just what consumers will get to see on those 40-inch plasma screens, not to mention Media Center PCs and even PDAs and wireless-phone handsets.

The outlook is mixed at best. For example, in 2005 film studios will finally make high-definition movies available on DVD. But the huge file size of HD content requires a new storage format—and new players. Unfortunately, a format war reminiscent of the VHS-vs.-Betamax struggle of the 1980s seems inevitable. The consumer-electronics industry is favoring an approach called Blu-ray, while most of the entertainment industry has gotten behind a rival standard called HD-DVD.

FOR THE FIRST TIME SINCE VCRs ARRIVED, consumers will see restrictions on what they can do with the broadcast and cable content they receive, especially HD programming. Regulations will require new TV receivers and other gear, including TiVo-type recorders, to honor “flags” that limit whether a show can be recorded and whether a recording can be copied to other media—such as a DVD—or otherwise distributed. Broadcast rules allow at least one recording for personal use and distribution of content within a home network. But cable content, such as HBO programming, can be much more severely restricted, including, at least in theory, a ban on recording.

The vigor of the new digital-entertainment media’s blossoming will depend on how restrictive content owners—mostly movie studios—are. Again, early signs are not good for consumers. Studios are pushing to tighten limits on copying and sharing content by lobbying the Federal Communications Commission, pushing for new legislation, and pursuing a

case before the U.S. Supreme Court. As long as Hollywood is driven more by piracy fears than by greed for new markets, the flow of content will be restricted, and the digital-entertainment market will fall short of its potential.

On the information technology side of the industry, 2005 promises to be the Year of Search. With Web search services now an established and profitable business, extending search to your own files and e-mail archives is the new frontier. Google made a test version of its desktop search program available in early fall, Microsoft jumped in with its version on Dec. 13, and Yahoo! has announced plans to distribute a free version of a search program called X1. Expect a proliferation of new search services—Web and desktop,

general and specialized—next year.

Unfortunately, various sorts of attacks on your computer are also bound to proliferate. The assaults—increasingly the work of serious criminals rather than thrill-seekers—are getting more sophisticated and dangerous and can lead to the theft of valuable personal or business information. I hope more service providers will follow the lead of America Online and take more direct responsibility for the safety of customers. But in the meantime it’s up to you to protect yourself. Windows users: If you run XP and haven’t upgraded Service Pack 2, do so now, and make sure to keep your antivirus and antispyware software up to date.

With diligence and some luck, you should enjoy a virus- and spyware-free 2004. I also want to thank all my readers for their support and wish you and yours health, happiness, prosperity, and peace in the year to come. ■

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BY ROBERT KUTTNER

What Killed Off the GOP Deficit Hawks?

Last month, I posed a rhetorical question: Whatever happened to fiscally prudent Republicans? The question deserves a proper answer. ¶ In the early 1990s the bipartisan, business-led Concord Coalition made the accumulated Reagan-Bush deficits a major public issue. George H.W. Bush had to break a pledge and raise taxes because of mounting concerns in

financial markets. H. Ross Perot put the deficit center stage in the 1992 election, helping to defeat Bush I and elect Bill Clinton. He made fiscal responsibility his signature issue.

A decade later, Republican deficit hawks have all but vanished. "It's pretty astonishing," I was told by Robert L. Bixby, executive director of the Concord Coalition. "We used to get a lot of Democrats saying: 'You're just a Republican front group.' Now it's almost the reverse. The change in the Republican Party has been astounding." Are we on the record? I asked. "Absolutely," he replied. "The Republicans are now the ones making excuses for big deficits."

The indefatigable Peter G. Peterson, a coalition mainstay, has become the remnant of an endangered species—the fiscally responsible Republican. He has just a few allies in Congress, such as Senators John McCain (R-Ariz.), Olympia J. Snowe (R-Me.), and, on a good day, Finance Committee Chairman Charles E. Grassley (R-Iowa).

HOW DID THIS SHIFT HAPPEN? Conversations with more than a dozen senior business leaders, including board members of the Concord Coalition, point to this progression: Since Ronald Reagan, a majority of Republican politicians have gradually come to conclude, as Vice-President Dick Cheney famously told former Treasury Secretary Paul H. O'Neill, that "deficits don't matter." What's interesting and alarming, however, is that different Republican factions believe deficits don't matter for opposite and incompatible reasons.

Supply-siders believe deficits don't matter because tax cuts so boost investment and productivity that the economy grows its way out of debt. The opposite, "starve the beast" faction, epitomized by tax tactician Grover Norquist, hope tax cuts will indeed create deep deficits that will then force spending cuts. But both things can't be true.

Under George W. Bush, the merry ideology calls for tax cuts in all seasons for all reasons. Spending has increased faster than under Clinton, and deficits have ballooned, yet tax cutting marches on. This privately scares many Republican business leaders. But very few are speaking out, either because they don't want to burn bridges to the White House or because they are too pleased with their tax cuts.

There is one other group worth noting. A decade ago fiscally

conservative Democrats, mostly Southern, often worked with Republicans to serve as a brake on fiscal excess. The near-extinction of Democrats in the mold of former senators Sam Nunn, Paul Tsongas, Fritz Hollings, and Representative Charles Stenholm, who was gerrymandered out of a job, has removed a crucial legislative counterweight to Republican recklessness. The days of bipartisan budget caps and pay-as-you-go rules are over. "Moments like the balanced-budget provision of Newt Gingrich's Contract with America were aberrational," says Steven Rattner, an influential Wall Street Democrat on the Concord Coalition board.

Inside the Administration, former deficit hawks have trimmed their views. Three senior economic officials are all men once well-known in private life as deficit critics. Stephen Friedman, who is stepping down as head of the President's economic council, was a Concord Coalition leader. Chief economist N. Gregory Mankiw, whose textbook correlates big deficits with higher interest rates, is leaving. Treasury Secretary John W. Snow, who once spoke out against fiscal imbalances, is keeping his job, barely.

Two factors could provoke Republican opposition to fiscal irresponsibility. The first is the risk of a dollar crash, directly related to big deficits. The second is the White House plan to borrow an additional \$2 trillion to finance Social Security privatization. The Administration story is that borrowing \$2 trillion in the short run will save the system up to \$11 trillion in unfunded liabilities over the next 75 years. The problem is that the supposed shortfall is hypothetical, while \$2 trillion of additional borrowing will affect real money markets now.

"I remain a Republican," Pete Peterson said, "but the Republicans have become a far more theological, faith-directed party, not troubling with evidence." ■

Robert Kuttner is co-editor of *The American Prospect* (rkuttner@prospect.org).

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U. S. Surgeon General

Dr. Richard H. Carmona, M.D.

Here is what we know: Healthy employees make good business sense. As a nation, we can no longer afford to wait until people get sick, and then spend billions of dollars each year trying to make them healthy again. That is why many business leaders are investing in helping their employees and the public to better understand and use health information.

Here is what you may not know: available now, at no cost to all Americans, is a personalized genomic tool that captures an individual's family health history and can be used by health professionals to suggest prevention strategies and testing for certain conditions earlier than would be recommended for the general population.

Your Family Tree

Tracing the illnesses experienced by parents, grandparents, and other blood relatives can help a healthcare professional to predict the conditions for which a patient may be at higher risk—and take personalized steps to keep that individual healthy.

If you know that breast cancer runs in your family, mothers and daughters should be tested earlier than standard guidelines suggest. If the men in your family die from heart disease, then fathers and sons should be monitored for cholesterol and high blood pressure earlier than is usually recommended.

Most diseases are due to interactions of multiple genes and environmental factors. In the future, sophisticated genetic testing and other related advances will

dramatically change how healthcare is practiced. In the meantime, knowledge of family health history can reduce risk and improve health and well-being.

To focus attention on the importance of family health history, the U.S. Department of Health and Human Services (HHS) has launched a national public health campaign called the U.S. Surgeon General's Family History Initiative. The goal of this initiative is to encourage all American families to discuss their family health history and to increase use of the family health history in disease prevention and health promotion.

Most Americans agree that family history is important. According to a recent study conducted by my colleagues at the Centers for Disease Control and Prevention (CDC), 96 percent of Americans believe that knowing their family history is important to their health. However, only one-third of Americans have ever tried to gather and organize their families' health histories.

Let's face it, discussing a grandmother's stroke or a brother's diabetes might not be the most welcome topic of conversation—yet this information could save a person's life.

To encourage family discussion of health history, we followed the example of businesspeople around the world—we decided that important conversations are best done over dinner. That's why I



declared Thanksgiving Day 2004 the first-annual National Family History Day.

Online Help

To help Americans gather their family history information, we have developed a free computer program that organizes health information into a print-out that an individual can take to his or her health-care professional. This print-out will help a healthcare professional determine if a patient is at higher risk for a disease.

This web-based computer program is called "My Family Health Portrait." It is available at www.hhs.gov/familyhistory. To order a print version, please call the Federal Citizen Information Center at 1-888-8-PUEBLO (1-888-878-3256) or write to "My Family Health Portrait," Pueblo, CO 81009.

Throughout the holiday season and this coming new year, I invite all Americans to initiate and continue conversations with their families about shared health history. Remember, we have information that when shared, might save the life of a loved one.



You've heard how much they cost. Do you know how much they save?

*F*act is, money spent on prescription medicines represents only about a dime out of every U.S. healthcare dollar. Yet, that money can save much, much more in other healthcare expenses. It's the cost of disease itself—doctor visits, tests, hospital stays, surgeries—that takes up the lion's share of the healthcare

costs. Take diabetes, for example. The average diabetic spends about \$1,200/year on medicine. Untreated, diabetes could cost a leg. The average cost to amputate a leg is \$32,300. But the real costs, of course, go beyond dollars and cents. The point is, an ounce of prescription prevention can be worth a ton of healthcare.



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Randy, smoke-free for 13 months

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HEALTH HORIZONS

Top Smoking—Sensible Advice for a Longer Life

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If you are a smoker, the best New Year's resolution you can make is to kick the habit. If you have loved ones who smoke, make a commitment to helping them quit.

Costs of Smoking

According to the 2004 Surgeon General's Report on the Health Consequences of Smoking, smoking kills an estimated 440,000 Americans each year. On average, men who light up cut their lives short by 13.2 years, and women smokers lose 14.5 years of life. The economic toll exceeds \$157 billion each year in the United States — \$75 billion in direct medical costs and \$82 billion in lost productivity.

Smoking causes serious illnesses such as cancer, heart disease, stroke, emphysema and other lung diseases, and can damage nearly every organ in your body. This is true for all types of cigarettes, at every stage of life. There is no safe cigarette. Even 'low-tar' or 'low-nicotine' products damage your organs, contribute to conditions like hip fractures, can cause reproductive complications, and put others at risk from secondhand smoke. Secondhand smoke poses a significant threat to all Americans, especially our children. Exposure to tobacco smoke is associated with childhood asthma and with Sudden Infant Death Syndrome (SIDS).

Benefits of Quitting

Some 25 million Americans alive today will most likely die of a smoking-related illness — but it's never too late to kick the habit and increase your chances of living a longer, healthier life. Within minutes after smokers inhale their final cigarette, their bodies begin a series of changes that can lead to a drop in heart rate; improved circulation; and reduced risk of heart attack, lung cancer, and stroke. Quitting at age 65 reduces by nearly 50 percent a person's risk of dying of smoking-related disease — and the odds only improve by quitting at an earlier age. If you are pregnant, quitting will also improve your chances of having a healthy baby.

Quitting tobacco is one of the most

Keys for Quitting

- Get ready — Set a date. Promise your family, friends, and co-workers. Request their support and ask them not to smoke around you.
- Seek professional advice from your doctor, pharmacist, counselor, or dentist.
- Consider medication. Ask your health care professional if prescription medication or nicotine replacement products are appropriate, and which type he or she recommends. Safe utilization of these products may improve your chance of success.
- Change your environment and avoid other smokers. Get rid of all cigarettes and ashtrays in your home, car, and place of work...and don't let people smoke in your home.
- Get individual, group, or telephone counseling. Consider hypnotherapy. Your healthcare practitioner, local hospital, or health insurer can point you in the right direction.
- Distract yourself from urges to smoke and reduce stress by talking to someone, taking a walk with a friend or a pet, exercising, and just planning enjoyable activities each day.
- Drink a lot of water and other fluids — but avoid alcohol, which lowers your chances of success.
- Don't let weight gain distract you from your main goal. Instead, eat healthy foods in healthy portions and stay physically active.
- Reward yourself — Set aside the money otherwise spent on cigarettes for a vacation or special gift.

important things you — or your friends and loved ones — will ever do. You will live longer, have more energy, and breathe easier.

The nicotine contained in tobacco is a very addictive drug, for some people as addictive as heroin or cocaine. If you have tried to quit smoking, you already know how hard it can be. Some people make two or three tries, or more, before success. With motivation, effort, the support of friends and family, and information about the best ways to quit, you can stop smoking for good and begin to reap the benefits right away.

If you decide to quit smoking...



A guide to resources and information that can help you succeed

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> If you decide to quit smoking, this is a good place to start.

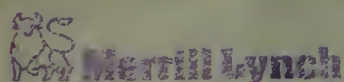
If you're quitting smoking, this 48-page guide can help. It points the way to a wealth of expert information from public health authorities and others, including:

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- > Quitting guides
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- > What's worked for others
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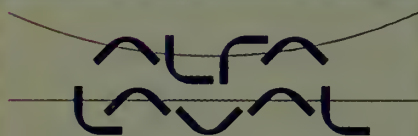
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BY JAMES C. COOPER & KATHLEEN MADIGAN

Consumers Are Piling On The Presents

ising employment and household wealth are bolstering spending

U.S. ECONOMY Consumers seem to be bustling through the holiday shopping season with an Alfred E. Newman attitude. Despite the burdens of high energy prices, low savings, and heavy debt, shoppers are saying "What me, worry?" as they head to the nation's retailers. Through November, retail sales are rising at the fastest quarterly

pace since the beginning of the year.

But this willingness to spend is not based on recklessness. Consumer resiliency is justified by two key supports: rising payrolls, which are generating more income, and increasing wealth, which also boosts households' ability to spend and borrow. That's why, despite all the hand-wringing over how consumers would far up under all of this year's burdens, spending for the year is on track to rise about 3.5%. Not bad at all. Consumer strength in the second half has been central to the resilience of the overall economy. For instance, industrial production had slowed this past summer, as businesses grew cautious about the possible negative impact of costlier oil on overall demand. But with consumers so steadfast, output is in catch-up mode, accelerating in the fourth quarter. And strong demand means that inventory gains are once again falling behind increases in sales. That's especially true at the retail level, suggesting continued additions to orders and output in coming months.

A good bit of U.S. demand is also benefiting foreign producers, given the October surge in imports. Nevertheless, while a wider trade deficit will be a drag on fourth-quarter growth, the economy remains on track to expand in the 3% to 4% range, a pace that seems likely to continue into 2005 (page 84), especially given the 25% drop in crude-oil prices from their summer peak. That pace is consistent with continued hikes in interest rates by the Federal Reserve. To no one's surprise, the Fed raised its target rate for overnight borrowing by a quarter point on Dec. 14, to 2½%. Policymakers also weighed in with a generally upbeat assessment of the economy. In that regard, the postmeeting statement was almost a carbon copy of the Fed's Nov. 10 announcement, though the policy committee did make a key procedural change. In another move toward greater transparency, the Fed will now publish the minutes of its meetings three weeks after a given meeting, instead of two days after the next scheduled meeting.

BE SURE, THE CONSUMER OUTLOOK is not free and clear. Energy costs are taking a bite out of household budgets, especially for lower-income families. And

consumers may be facing a bit more inflation for other items over the coming year as companies push to raise prices to cover higher production costs.

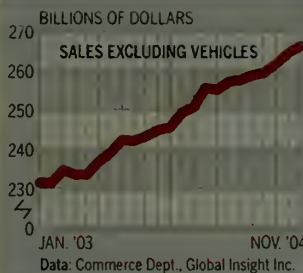
But for now, at least, shoppers are shrugging off any impediments during the holiday shopping season. Total retail receipts rose 0.1%, with a drop in vehicle sales accounting for the slim gain. Excluding cars, sales posted a broad 0.5% increase (chart). In addition, the sales gains in October turned out to be greater than the Commerce Dept. initially estimated, with overall buying rising 0.8% and nonauto sales up 1.1%. For the first two months of the fourth quarter, nonauto retail sales are growing at an annual rate of 8.5% before price adjustment.

Depending on how active shoppers are in December, real consumer spending in the fourth quarter appears to be on its way to an increase of about 4%, at an annual rate.

WHY ARE THESE NUMBERS SO UPBEAT when retailers are worrying about a dismal holiday season? First, chain-store sales track receipts from a narrow array of merchants, such as general merchandise stores, apparel stores, and discounters. The spending data compiled by the Commerce Dept. are different. Commerce surveys a wide range of vendors from grocery stores and Internet sites to restaurants and bars. Picking up a bottle of aspirin or filling the gas tank may not be what we mean when we talk about "going shopping," but to Commerce, such errands are a key part of retail sales.

Second, chain-store sales limit their comparisons to stores open at least a year. That allows them to calculate a percentage change in sales from the previous year that is consistent over time. But growth from the year before sometimes can say more about last year's sales strength than this year's. For example, 2003's yearend shopping was lifted by tax cuts and rebate checks. That boost in

RETAIL SALES REACH FOR NEW HEIGHTS



sales will make it tougher to show a big gain when chain stores tally their 2004 receipts. Commerce surveys stores no matter how long they have been opened, and it looks at sales from month-to-month, adjusted for seasonal patterns.

TO UNDERSTAND WHY consumers are holding up so well, consider two trends over the past year: Household income from wages and salaries, some 60% of overall personal income, has grown 5.1%, nearly two percentage points faster than inflation. This time last year, wages-and-salary incomes were growing only 3.7%. The difference: More people are at work. In 2003 payrolls made no headway, but in 2004 payrolls appear to have risen by two million workers.

In addition, household net worth is also soaring. The Fed's latest data on the balance sheet of Household America show that net worth—the value of all assets minus liabilities—rose by \$546 billion in the third quarter, capping an increase of \$4.3 trillion over the past year. In fact, household wealth is rising at a pace that matches the gains seen in the late-1990s (chart).

After the stock-market bust, net worth fell erratically for three years. But since bottoming out two years ago, it has grown by \$8 trillion, driven by a \$9.8 trillion increase in assets. That gain was more than five times greater than the \$1.9 trillion rise in household liabilities. The increase in assets breaks down to about 40% coming from tangible assets—mainly rising home values—and about 60% stemming from fatter financial assets.

Stronger balance sheets lessen the importance of the official measure of personal savings as a guide to consumers' well-being. So far in 2004 savings have averaged 0.9% of aftertax income, the lowest ever. But that measure only considers what remains of household income after subtracting the income that has been spent

in a given period. In recent years, households have chosen to save in other ways. For example, rising home values are clearly an untapped source of savings for many consumers.

The enormous increases in asset values over the past two years give households plenty of collateral to take on more debt. Moreover,

WEALTH IS RISING AT A RAPID CLIP



households are managing their debt service well. Despite the big rise in debt over the past two years, debt service as a percentage of aftertax income, while at a high level historically, is lower now than it was two years ago, thanks to the pickup in income growth.

The gains in income as well as wealth explain why check-out lines might be long this holiday season. What's more important is that as long as job growth holds steady and the Fed moves gradually, consumers won't have to turn into Scrooges when 2005 begins. ■

JAPAN

Will Tokyo Stay Focused on Reform?

AT SOME POINT, Japan will have to get serious about fiscal reform. Already, the government is looking at proposals for lifting taxes and cutting spending. But are the politicians and the economy up to it?

The Japanese government has dug itself into a deep hole. Its ratio of debt to gross domestic product is 1.45, the highest in the industrialized world, and the budget deficit is running at 7% of GDP, about twice that in the U.S. This is why Japan's sovereign debt rating is now the lowest in the industrialized world.

Economy Minister Heizo Takenaka is beginning to develop a reform agenda, starting with a proposal to repeal the broad 1999 tax cuts. A

public opinion poll taken by Takenaka's commission on reform revealed that many Japanese favor reform, but the task is daunting.

Given the necessary adjustment, with one-fourth coming from tax hikes and three-fourths from cuts in spending—similar to the proportions indicated in the opinion poll—Morgan Stanley analyst Robert Feldman estimates that the

consumption tax would have to double, from 5% to 10%. On the spending side, he says that public works outlays would have to be cut by more than half, in addition to very large cuts in social spending.

But how much will Japan's powerful Liberal Democratic Party support the

reform effort? With the 2005 budget process about to begin, the betting is that the LDP will look for compromise on the rollback of the 1999 tax breaks.

One reason: New figures on economic growth, based on new statistical methods, show much slower growth for the past year and a half, compared with earlier data. Japan has made scant progress in righting the long-term problems that have crippled its domestic economy. Now, a global slowdown, costlier oil, and a soaring yen are hitting exports, which grew last quarter at the slowest pace in more than a year. Based on soft October data and slippage in the December Tankan survey of business sentiment, the economy weakened further this quarter.

Even Takenaka recently said that reform needs to be "flexible" based on the economy's health. Meanwhile, the government's hole is getting deeper. ■

NEW DATA SHOW WEAKER GROWTH

	JAPAN'S REAL GDP	
	ORIGINAL	REVISED
2003*	3.2%	1.9%
2004 QII	1.1	-0.6
2004 QIII	0.5	0.2

*FISCAL YEAR: MAR. 31, 2003, TO MAR. 31, 2004
COUNTRY DATA ARE ANNUAL RATES
Data: Citigroup, J.P. Morgan Securities Asia

DRINK RESPONSIBLY



JOHNNIE WALKER

PLEASE DRINK RESPONSIBLY

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STRATEGIES

THE CASH HEADS HOME

For a one-time tax break, companies could repatriate \$300 billion next year. But what will they do with it?

IT'S A CASH BUNDLE THAT WOULD have made Howard Hughes blush: As U.S. multinationals such as IBM and Pfizer Inc. have extended their reach across the globe, they've built up a mountain of profits earned abroad—as much as \$750 billion, by some estimates. That's more than the annual economic output of Hong Kong, Ireland, and Switzerland—combined. And up till now, they've kept all that moolah overseas, much of it in tax havens such as the Bahamas, Ireland, and Singapore to avoid the stiff 35% levy they'd face if they repatriated the funds back into the U.S.

But now it looks as if Corporate America is gearing up to bring a chunk of that cash home. Thanks to a provision in the corporate tax law enacted in October, Congress is giving multinationals the chance to repatriate profits earned before 2003 and held in foreign subsidiaries at an effective 5.25% tax rate. To qualify for that rate, the money has to be brought

back to the U.S. before the end of 2005, and spent in ways that stimulate job creation and the economy.

As a result, economists are expecting as much as \$300 billion to come washing ashore next year, as companies seize the chance to lock in at the ultralow tax rate. Outfits as varied as Intel, 3M, and Heinz expect to repatriate gobs of cash, potentially using it for everything from refurbishing aging plants and shoring up balance sheets to launching acquisition sprees. And while the injection is not expected to produce many jobs, it should provide a nice jolt to the economy and a lift for the stock market.

Robert Mellman, an economist at J.P. Morgan Chase & Co., predicts the flood of money could boost gross domestic product growth by as much as a half-point in 2005, to 3.5%, on the strength of a pickup in hiring, research and development, and capital spending. "This was money that was going to sit abroad and never come

SO IN THIS SECTION:

5 Pricing power is back. Why not inflation?

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48 Software deals: Growth but often grief, too

49 GM and Daimler: At last, hipped on hybrids



back," says Meliman. "The U.S. is getting something for nothing."

So far, a handful of companies have indicated they expect to bring cash home. Food giant Heinz says it may repatriate \$1 billion in foreign earnings. And drugmaker Johnson & Johnson is expected by analysts to use some of its \$14.8 billion foreign hoard to finance a possible acquisition of Guidant Corp.

"DELIBERATELY SLOPPY"

BUT FOR THE MOST PART, companies are being cagey about their plans. That's because they're not sure what they will be allowed to use the cash for. As one congressional aide points out, the law "was deliberately sloppy" to give companies as much leeway as possible in how they spend their hoards. Execs say they are waiting for the Internal Revenue Service to release final rules in coming weeks that will spell out exactly what types of transactions qualify for the low tax rates. "The driver is how we can use that cash in the U.S. And that is still not clear," notes Merck & Co. chief financial officer Judy C. Lewent.

In the end, analysts believe companies will have great latitude to spend as they please. "Given the fungible nature of cash," says Greg Kelly, a federal policy analyst at Susquehanna Financial Group LLP, a Bala Cynwyd (Pa.) institutional brokerage and research firm, "who's to say which pocket the money's coming from?"

While companies aren't saying much, hints are emerging about what they plan to do. Stock buybacks seem to be high on the list, with Franklin Resources, a San Mateo (Calif.) mutual-fund firm expected by analysts to repatriate part of its \$2 billion in foreign cash to fund share repurchases, and, if allowed, special dividend payouts. Standard & Poor's chief economist David A. Wyss believes such foreign-fueled buybacks could boost per-share earnings for the Standard & Poor's 500-stock index by two percentage points, to 7%. "It's coming at a time when the dollar is already down, so companies will be eager to recognize foreign profits," he says.

Others will use the money to get their

fiscal houses in order. A J.P. Morgan survey of 28 multinationals revealed that 13 of them plan to use their proceeds primarily to clean up balance sheets. 3M Co., for example, says it plans to repatriate roughly \$800 million of the \$6.2 billion it holds abroad: The money will go toward retiring debt, shoring up pension funds, or making acquisitions. And in the pharmaceutical sector, analysts believe Merck may bring back some of its \$15 billion to help protect its sacrosanct dividend in the face of a mounting legal bill from the Vioxx withdrawal. Drugmaker Schering-Plough Corp. says it may tap some of its \$9.2 billion to meet the

U.S. multinationals could sell as much as \$50 billion in new debt in 2005 to repatriate profits. Ultimately, other bond-market mavens believe the total borrowing could run three to four times that sum.

Repatriating could pose a risk for some companies, though. Michael Levesque, a senior analyst at Moody's Investors Service, warns that abruptly cutting cash holdings—even in a foreign subsidiary—could trigger a downgrade among companies with shaky finances. "We've given credit for that cash," says Levesque. "There could be a negative ratings impact if they spend it on anything other than debt repayment."

For tech and pharmaceutical companies especially, the new cash could shore up R&D budgets. Allen Sinai, president and chief global economist of Decision Economics Inc., predicts R&D spending will increase by an extra \$7 billion, to \$10 billion over the next two years as a result of repatriation. Already, Intel Corp. has said it may tap some of its \$6 billion to cover the cost of upgrading several aging chip factories this coming year, a costly process that's ex-

Overseas Stash

The Top 10 in cumulative unrepatriated foreign earnings through 2003

IN BILLIONS OF DOLLARS

PFIZER	J&J
\$38	\$14.8
EXXONMOBIL	P&G
\$22	\$14
GE	ELI LILLY
\$21	\$9.5
IBM	PEPSICO
\$18.1	\$8.8
MERCK	ALTRIA
\$15	\$8.6

Data: Citizens for Tax Justice, based on company annual reports. Merck & Co.



HEINZ IN HONG KONG

The food giant may repatriate \$1 billion in foreign earnings

needs of cash-strapped U.S. operations.

Wall Street dealmakers believe that any moves to clean up balance sheets could lead to mergers. "This is just one more impetus for increased M&A activity," says Stefan Selig, vice-chairman of Banc of America Securities. Besides J&J, Oracle Corp. is expected to leverage its overseas cash to go after other software firms.

A SPARK TO BORROWING?

MOREOVER, SOME WILL DO the opposite of cleaning up their balance sheets to take advantage of the tax holiday. Since many companies have already sunk past profits into illiquid investments such as manufacturing plants, Wall Street pros expect them to borrow funds against those assets to qualify for the ultralow rate. Krishna Memani, global group head of credit strategy at Credit Suisse First Boston, predicts that

pected to run about \$2 billion per plan.

And what about using some of the money to expand payrolls—the stated intent of the law? Don't bet on it. With companies wringing ever-higher levels of productivity out of their current workforce—and reluctant to take on the obligations that come with new hiring—economists doubt that a repatriation of profits will lead to a wholesale hiring boom. Indeed, Sinai expects the repatriation rush to create just 118,000 jobs in each of the next five years—far less than the 500,000 that politicians promised. But if this cash surge keeps the economy humming while longer, that may be a trade-off law makers are willing to make. ■

—By Dean Foust in Atlanta, with Howard Gleckman in Washington, Am Barrett in Whitehouse Station, N.J. and bureau repor

COMMENTARY

BY RICH MILLER

Pricing Power Is Back—But Inflation Isn't Likely to Follow

There's still plenty of overcapacity, and the Fed is keeping a steady hand

THERE'S A WHIFF OF inflation in the air. Import prices are up, courtesy of the weak dollar. Producer prices are surging—in November they rose at a year-over-year rate of 5.1%, their fastest clip in 15 years. Even at the consumer level, where price competition is keenest, some companies are finding that they can pass on their higher costs to their customers. On Jan. 1, Whirlpool, Electrolux, Maytag, and General Electric each will jack up big-ticket appliance prices 5% to 10% to cover their higher bills for steel and other materials. That's the steepest hike in at least five years.

What's going on? It's all about supply and demand. Demand is being fueled by a global economic recovery and a still-accommodating monetary policy by the Federal Reserve. Supply, meanwhile, is getting tighter thanks to industry consolidation and a continued reluctance by companies to add capacity. The weak dollar is also playing a large role, says Standard & Poor's chief economist David Wyss, because it curbs foreign competition. Put it all together and it's hardly surprising that price pressures are growing.

Indeed, after years of having to swallow higher commodity prices and other rising costs, many companies are finding they are finally able to pass those price hikes along to customers for the first time since the 2001 recession. In some cases they're racking on more. Dow Chemical Co., for one, raised its average selling prices in the third quarter by 19% from a year earlier, more than making up for the jump in its energy costs. With supplies tight—Dow is running its plants at 90% of capacity—corporate customers had little choice but to accept the price hikes. “Pricing power is returning to the producers,” says CEO Andrew N. Liveris. “The market is robust.”

Steel companies are also enjoying more pricing leverage. Stainless steel prices are up 80% since January, 2003, while carbon steel prices have doubled in 2004. “There has only been one other period, which

Now that business travel is up, hotels are raising rates



SHINING STEEL Polished by consolidation and more global demand

was World War I, when there's ever been a price spike as great as this year,” notes Maytag CFO George C. Moore, whose company is a big buyer of steel.

Besides global demand, steelmakers are benefiting from tighter supply from industry consolidation. In just the last two years, U.S.

Steel gobbled up National Steel, while International Steel Group consolidated LTV, Bethlehem Steel, and Weirton Steel, and Nucor acquired Birmingham Steel and Trico Steel. And that's hardly the only industry undergoing consolidation, as a slew of high-profile mergers over the past month shows. Deals include Oracle's purchase of PeopleSoft and Sprint's pending linkup with Nextel Communications, to name just a few.

Prices are also on the rise in service industries. Tighter supplies are helping the travel business recover pricing power after several rough years. Hotel construction slowed dramatically over the past three years, to an average of 80,000 new rooms, half the level of 1998, according to PricewaterhouseCoopers LLP. With business travel beginning to pick up, that's enabling companies such as Hilton Hotels Corp. to boost rates. Hospitality consulting firms PKF Consulting and Torto Wheaton Research figure the average hotel room rate in the 50 largest U.S. markets will rise by 4.7% in 2005, to \$102 per night.

So with prices bubbling up, is a burst of damaging inflation on the way? Probably not. Many industries, still saddled with excess capacity, can't raise prices. The biggest: carmakers and airlines. And global growth is starting to cool, in part because of efforts by China to rein in growth. That's taking some edge off commodity prices, particularly oil, which has tumbled some \$10 from its October peak. Another moderating factor: On Dec. 14 the Fed raised rates by another quarter percentage point and signaled that more hikes are in store. As the Fed sticks to its plan, inflation shouldn't prove much of a problem. ■

—With Michael Arndt in Chicago and Christopher Palmeri in Los Angeles



TELECOMS

WHY SPRINT AND NEXTEL GOT HITCHED

They buy themselves enough time and size to play with the big boys. For now

IN THE WORLD OF BIG-TIME TELECOM, the Baby Bells have been hogging the spotlight as they bulk up to compete against an onslaught of new technology—and their arch-rivals, the cable companies. For competitors hovering outside the Bells' territory, that sends a stark message: Team up or get smashed. Sprint Corp. and Nextel Communications Inc. chose the former, announcing on Dec. 15 a \$35 billion deal to merge into

the third-largest wireless powerhouse. With a market capitalization of \$70 billion, the new Reston (Va.)-based Sprint Nextel hopes to gain the girth it needs to go up against the two leading Bell-owned wireless giants—Cingular and Verizon Wireless—and the wherewithal to forge ahead into the broadband future. "This is about creating the next-generation communications company," says Sprint Chief Executive Gary D. Forsee, who will head the combination.

Indeed, the deal leaves Sprint Nextel poised to play a pivotal role in the coming convergence between traditional and wireless phones, Web access, and video services. As the Bells race against the cable operators to sell consumers everything from voice to data to video, both sides need wireless phone services to sweeten their bundle of offerings. The Bells already own their own wireless companies—but cable companies don't. Sprint Nextel can provide a ready-made wireless offering for cable's four-fer pack. "The cable companies are clearly looking for a wireless play," says Nextel CEO Timothy M. Donahue, who will be chairman of the new company. "This [merged] company is going to be remarkably successful in attracting partners."

FIRST, SURVIVAL

FOR THE LONGER TERM, Sprint Nextel envisions a bolder course: Competing in its own right against the Bells and cable operators in the market for convergence services. The two wireless carriers together own enough airwaves, stretching coast-to-coast, to offer voice, data, and

HAPPY COUPLE Sprint's Forsee and Nextel's Donahue announce the merger

even video over next-generation wireless broadband technology, such as the much-ballyhooed, upcoming WiMax standard.

That grand vision aside, the immediate driver for the deal is survival. Cingular, a joint venture between SBC Communications Inc. and BellSouth Corp., vaulted into the No. 1 spot in the wireless universe with 47 million subscribers after its October acquisition of AT&T Wireless. And Verizon Wireless' tagline—"Can you hear me now?"—echoes in competitors' ears as the No. 2 player hits 42 million users and growing. Sprint, a distant third with 20 million customers, and No. 5 Nextel, with 14.5 million, need each other to hold their own. While Sprint has local and long-distance businesses in addition to wireless, it doesn't have the scale to compete over the long haul with the Bells. And though Nextel has the wireless industry's highest margins, its focus on a unique niche—push-to-talk service to

business users—is too narrow to sustain an independent company as the industry consolidates.

Together, Sprint Nextel will have 35 million customers, as well as business models that could mesh smoothly. Sprint, which will spin off its local phone business as part of the merger agreement, focuses on consumers, a complement to Nextel's business users. "They're yin and yang," says former Nextel CEO Daniel Kerson, now a managing director at the Carlyle Group. "They'll be the best, biggest, and baddest pure wireless play in the U.S." Precisely because Sprint and Nextel barely overlap, federal regulators are likely to give the deal the green light.

Each party in the new duo can help the other expand in new markets. Nextel, for instance, needs Sprint's innovative know-how in creating new wireless data applications in mobile music, video, and games to go after the youth consumer market with its

Boost Mobile brand. Then, Sprint can expand in the business market by helping to bolster Nextel's attempt to equip corporate campuses with communications services. Sprint's long-distance networks, along with Nextel's wireless offering, give companies a more complete offering.

The deal also lets each company solve the other's technological headaches. Nextel uses a special wireless technology that no other carrier uses. Without Sprint, Nextel would have to build an entirely new network to offer customers e-mail and video services that zip along at speeds up to 300 kilobits per second. By piggybacking on Sprint's digital network, Nextel can save much of the \$2 to \$3 billion it would otherwise spend to build its own next-generation infrastructure, analysts say.

For Sprint, Nextel's appeal is a bigger chunk of the airwaves. Sprint's current spectrum isn't big enough to carry music downloads, video games, and other data-heavy services. The combined company's bandwidth will rival those of Cingular and Verizon Wireless. "Getting the spectrum was essential for Sprint," says Phil Cusick, wireless-services analyst for Bear, Stearns & Co. What makes the deal especially sweet: Nextel has struck an agreement with federal regulators to swap its old spectrum for new airwaves better suited to faster broadband speeds and better penetration inside buildings. Faster broadband can deliver consumers more video gaming and richer content wirelessly. And better reception in buildings will position Sprint Nextel to sell businesses a new type of go-anywhere wireless phones that workers can use reliably either at their desks or on the go.

In consumer markets, Sprint Nextel could also thrive as a wireless whole-

Defensive Play

How the new Sprint Nextel fits into the changing telecom landscape:

WIRELESS The new company, with 35 million subscribers, will be a powerful No. 3 behind Cingular and Verizon. But it will lack the depth of bundled services offered by its larger rivals.

CABLE The industry is scrambling for its own wireless strategy to bundle with video, data, and voice. A Sprint Nextel pairing could prompt cable companies to team with it.

BROADBAND The merger will create a company with the potential to roll out coast-to-coast WiMax, a wireless rival to DSL and cable broadband, by 2007. That could pose new competition to the cable players and the Baby Bells alike.

saler for the cable giants. Cable companies, with digital lines able to reach 96% of U.S. households, are ahead for now in the new race to offer converged telecom and entertainment services. The Bells are just starting to build ultra-fast fiber networks to homes and neighborhoods to offer voice, data, and video. But the Bells have wireless to grab back the lead—and cable doesn't. "Cable executives are petrified," says one media investment banker. That's why Comcast, Time Warner Cable, Cox, Charter, and BrightHouse Networks (Advance/Newhouse's cable holdings), have formed a consortium to assess their wireless options. For now, they'll likely buy wireless services from a partner rather than purchase a wireless operator outright. That's a ripe opportunity for Sprint Nextel.

Eventually, the new company could move beyond a sidekick role to the cable industry. In the longer term, Sprint Nextel's ownership of another slice of spectrum, allocated specifically for wireless broadband, could make it a full-fledged competitor to the Bells and cable. The merged company could be among the first to blanket the country—reaching 85% of the population in the nation's top markets—with this untapped spectrum. In a few years, Sprint Nextel could decide to deploy a variation of WiMax technology in those bands to offer a suite of data, voice-over-Internet, and even video services—creating a new broadband powerhouse.

Realizing that vision will be expensive, though, and it will require rapid adoption of new technology. By merging, Sprint and Nextel have bought themselves time, and perhaps enough scale to play with the big boys—for now. But in a telecom world ruled by the Bells, scrappy competitors like Sprint and Nextel remain underdogs. Alone or together, they still face a tough fight. ■

—By Roger O. Crockett in Chicago and Catherine Yang in Washington, with Tom Lowry in New York

Sprint gets a chunk of spectrum; Nextel, a state-of-the-art network

COMMENTARY

BY JIM KERSTETTER

The Soft Underbelly of Software Deals

Consolidation can help to safeguard growth, but it's notoriously tough to pull off

IT'S BEEN A HECK OF a week for the software industry. First there was Oracle Corp.'s Dec. 13 long-sought-after deal to acquire rival PeopleSoft Inc. for \$10.3 billion. Then word leaked out that Symantec Corp., the top seller of computer security software, and storage-software maker Veritas Software Corp. entered into talks over a merger that could be worth \$13 billion. It heralded,

according to Oracle CEO Lawrence J. Ellison, a new era of dealmaking. "When the No. 2 buys the No. 4, it reshapes the industry," he said. "It kicks off consolidation in Silicon Valley."

He may well be right. And there's plenty to suggest that a wave of deals is coming. Consumer and business spending on software, which saw double-digit annual growth through the 1990s, isn't coming back soon. Worldwide software sales are expected to increase 6% next year, according to market researchers at Gartner Inc., barely higher than the growth rates in each of the last three years. That means new customers are getting harder to come by, and pressure on prices remains fierce; for most, mergers may be the only route to hefty growth. Ellison is already scouting ahead for his next deal. After the PeopleSoft merger is digested in a year or so, he wants to look at other targets such as BEA Systems Inc., a San Jose (Calif.) software company that helps companies run their businesses over the Internet.

Yet before all the investment bankers start licking their chops, it's worth remembering that mergers in software and other tech sectors are notoriously problematic. Remember Microsoft's aborted merger talks with SAP earlier this year? And once a deal is done, lots can go wrong. For proof of that look no further than PeopleSoft's 2003 acquisition of J.D. Edwards. The deal has disappointed investors because it has proven far more difficult to realize cost savings than PeopleSoft had expected. As Ellison has often pointed out himself, a software company's biggest asset is its programmers, and the best of them can find another job if they don't like the new employer. What's more, it



MERGER MANIACS
Oracle's Ellison
(top); Symantec's
Thompson

can take months, even years, to make different software packages work together.

Of the two latest deals, appears Oracle will have the tougher job integrating its new assets. Indeed, Ellison could quickly discover that bringing PeopleSoft—or any other companies he may go after—into the fold won't be easy. He'll have to keep PeopleSoft's customers happy to maintain the hefty stream of

maintenance revenues they now pay. That means keeping the bulk of PeopleSoft's development group, as well as enough sales and service staff to work with those customers. At the same time, Ellison has com-

mitted to aggressive cost-cutting. He promises the deal could boost Oracle's earnings as early as the quarter that ends in May.

Ellison has already begun the process of soothing PeopleSoft customers who were dead set against the merger, assuring them that Oracle will continue to support their software. But many are taking a wait-and-see attitude. Says Ken Meidell, chief information officer at Cascade Designs Inc. in Seattle: "I don't know how they will be able to satisfy their Wall Street friend and the PeopleSoft customers and their own customers."

Symantec is in a stronger position. Since CEO John W. Thompson took over the Cupertino (Calif.) company four years ago, Symantec's sales have grown at better than 40% per year, while the rest of the software industry has sputtered. The company now has more than \$2.4 billion in annual sales and a \$17.4 billion market cap. Yet it's also on the acquisition trail because security software is attracting new, tough competitors. If Microsoft Corp. enters the market for antivirus soft-

ware, for instance, Symantec's fastest-growing and largest segment will be imperiled.

Yet its deal is no sure bet, either. Symantec and Veritas, which combined would have about \$4.4 billion in annual sales, operate in different markets, leaving far fewer opportunities for cost-cutting than Oracle has. Sure, there may be more deals like these coming. But don't expect them to go smoothly. ■

—With Steve Hamm in New York

**Can Oracle
assuage
PeopleSoft's
customers,
its own, plus
Wall Street?**



AUTOS

GM AND DAIMLER ARE STEPPING ON IT

They're teaming up on hybrids to counter rivals' unexpectedly popular models

GENERAL MOTORS CORP. and DaimlerChrysler have been among the last major carmakers to get behind gasoline-electric hybrids. While Toyota, Honda, and Ford all have months-long waiting lists for their hybrids, GM and Daimler have scoffed at the technology. Daimler has bet heavily on diesel engines, arguing they're better at saving fuel. While GM has said it would produce hybrids, it has asserted that hydrogen fuel cells are the real future.

So why are the two giants suddenly rushing to get into the race? On Dec. 13, the pair announced they would team up to build hybrid systems that will help both companies develop fuel-efficient vehicles faster and more cheaply. Fact is, GM and Daimler have little choice: Hybrids are fast becoming America's fuel-saver of choice, and the longer these two wait, the further behind technology leader Toyota Motor Corp. they risk falling. "Neither company was sold on hybrids two years ago," says Brett Smith, analyst at the Center for Automotive Research (CAR) in Ann Arbor, Mich. "But they've realized there's a market."

Catching their rivals will require hitting the gas hard, though. While Toyota is already on its second-generation of hybrid

offerings, the first models from the GM-Daimler collaboration won't roll off the line until 2007. By then, the Japanese giant will have had two more years to perfect its technology, build up sales volume, and bring down costs for what remains a pricey product. Even Honda and Ford, which aren't as far along as Toyota, will be between them have six hybrids on the market by then. GM knows what it has to do. Says Thomas G. Stephens, group vice-president for powertrain development: "I have to offer good value, so I need to get the costs down."

That explains the tie-up with Daimler. GM had already planned to sell hybrid SUVs in 2007, but it needed partners to help defray the development outlays. By sharing its hybrid technology with Daimler, moreover, GM is betting that the more models out there, the cheaper it will be to produce them. Longer term, GM hopes to persuade other carmakers to license its technology. Toyota already has licensed hybrid patents to Ford, sold a system to Nissan, and talked to Porsche.

At least GM and Daimler won't be

TRIAL RUN Future models will be based on GM's hybrid buses

starting from scratch. A few years ago, GM developed a hybrid system for city buses, figuring public transit authorities had a greater need to save fuel than the average driver. GM's technology powers 335 buses in 18 U.S. cities. The idea is to modify that technology for passenger vehicles. GM will focus on truck and SUV hybrids; Mercedes on big luxury sedans.

PUSHING THE TRUCKS

IT IS NO ACCIDENT that GM and Chrysler will put the new hybrid system into their trucks first. Downsizing a system first designed for big buses so that it works in SUVs such as the Chevrolet Tahoe and Dodge Durango can be done with only minimal changes to the technology, says CAR's Smith. By contrast, he says, Toyota's system—designed for small and mid-size cars with front-wheel drive—may require more changes to make it work in big rear-drive trucks. What's more, GM's hybrid technology is expected to cut SUV fuel consumption by 25%, to about 21 mpg. That's a big deal in a segment that generates most of the operating profits at GM and Chrysler.

THE STAT

**21
MPG**

Expected gas consumption of GM SUVs with hybrid engines—a 25% gain over today's 17 mpg

Data: General Motors Corp.

First, though, the duo will have to get the technology right. One of the biggest challenges: developing the software that controls a hybrid's gas and electric motors. Rivals say it will be hard to fine-tune technology designed for buses for regular vehicles. Says one Honda Motor Co. exec: "No one expects a bus to run smoothly."

Meanwhile, the hybrid pioneers aren't sitting still. By 2007, Toyota alone expects to have sold 200,000 hybrids, giving it the kind of sales volume that could provide a big cost advantage

over GM and Daimler. Today, hybrids still cost an average of \$3,500 more than conventional vehicles—a premium Toyota and Honda would like to cut in the long run. "If GM's technology were launched this year, it'd be very competitive," says Lindsay Brooke, analyst at auto consulting firm CSM Worldwide Inc. "But by 2007, there will be a number of new hybrids in the marketplace."

GM and Daimler are finally taking hybrids seriously. Now their engineers will have to prove they can deliver. ■

—By David Welch in Detroit

LEGAL AFFAIRS

WHY THE GROKSTER CASE MATTERS

The high court faces a hard choice between innovation and copyright protection

FOR YEARS, THE MUSIC and film industries have fought a Sisyphean battle against piracy. Companies estimate that online thieves download 2.6 billion illegal music files and some 12 million movies every month, costing them millions of dollars a year. On Dec. 10 the media bigs landed a rare win: The U.S. Supreme Court agreed to review a lower court's decision against the studios in *Metro-Goldwyn-Mayer Studios Inc. v. Grokster Ltd.* The studio's complaint has a high-profile list of backers, from the Dixie Chicks to Major League Baseball to the attorneys general of 41 states. If the court overturns the ruling, it could shift an unsteady balance between technology and

creativity that has nurtured two decades of innovation in consumer electronics. The key issues:

What do the studios want?

Hollywood and the recording industry have asked the Supreme Court to decide whether Grokster, a file-swapping service, can be held liable if its customers violate copyrights when they use it to pluck songs, movies, and other types of files off the Internet. The U.S. Court of Appeals for the Ninth Circuit said it can't.

Why did the lower court clear Grokster?

The appeals court relied on the Supreme Court's 1984 decision in *Sony Corp. v. Universal City Studios Inc.*, a seminal case that challenged the legitimacy of that era's cutting-edge technology, the Betamax videocassette recorder. The High Court rejected Universal's argument that Sony should be held liable for copyright violations committed when Betamax users taped TV shows. Because VCR technology was capable of "substantial non-infringing use," the court gave video recorders the green light. In August, the appeals court ruled that the same principle applies to peer-to-peer technology used by Grokster and others.

Why are technology companies so worried about the Grokster appeal?

The 1984 Betamax opinion didn't make the world safe just for VCRs. It created a safe haven for dozens of other popular technologies, includ-

DIXIE CHICKS

Studios have sued thousands for downloads

ing CD recorders, music players such as Apple Computer Inc.'s iPod, and digital video recorders such as TiVo. Indeed, many of these technologies were challenged by the recording and movie industries—unsuccessfully, thanks largely to Betamax. If the high court changes direction with Grokster, electronics firms worry that copyright holders will try to outlaw any new product or service that could be used to commit piracy. In short, a ruling against Grokster could stifle technology innovation.

Wasn't this debate put to rest when the courts shut down Napster?

The Ninth Circuit chipped away at the Betamax precedent when it took Napster offline in 2001. The court said Napster was liable for piracy because users tapped into its central servers to swap files. Grokster is different because it simply supplies free software that enables individual PCs to talk to each other and swap music and other digital content. Since Grokster has no role in the actual file exchange, it argues that it shouldn't be punished for its customers' bad behavior.

So why do the studios blame it?

Grokster makes money by selling ads that are viewed by visitors who come to its Web site to download free file-sharing software. Studios claim that some 90% of the millions of daily downloads using Grokster software violate copyright. If all those rogue downloaders stopped visiting Grokster's Web site, the company would not have enough traffic to sell ads. That the studios charge, makes Grokster a



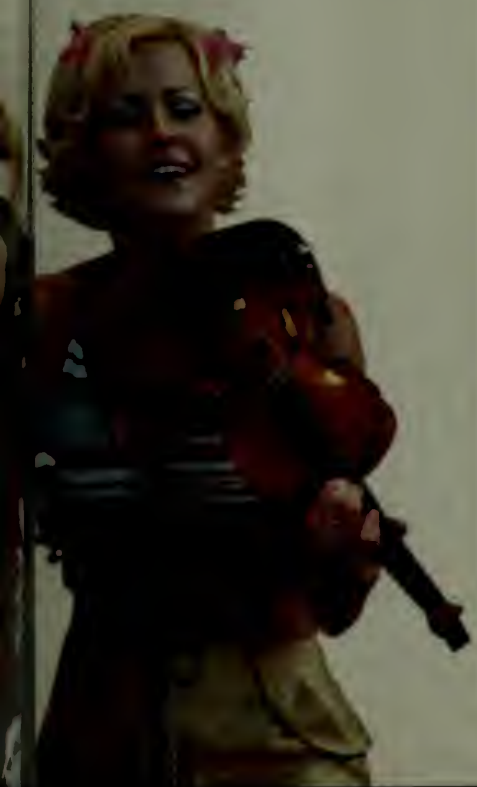
"infringement-dependent" business—one that profits from people who steal music. One question that the court will consider is whether the legal 10% of Grokster activity is "commercially significant" enough to let Grokster off the hook. It might be: In the Betamax case, studies estimated that less than 10% of VCR recordings were authorized by content owners. On the other hand, the damage done by the illegal 90% of Grokster activity is much greater because of the power of digital technology.

But movie studios and musicians are losing millions of dollars to online piracy. Don't they need protection, too?

Of course. The problem is finding a way to protect copyright holders without blocking important innovations such as the iPod. One approach is to sue the pirates. Studios have brought thousands of suits against people who download music and movies. On Dec. 14 the Motion Picture Association of America hatched up the legal assault, suing more than 100 people who maintain Internet road maps for finding illegal copies of movies and TV shows.

But targeting individuals is expensive and unpopular: Big studios win no friends by busting music-sharing teenagers. So the content industry would rather choke off piracy by targeting the technologies. That carries risks, too. Until a new balance can be struck, consumers will be caught in the middle. ■

—By Lorraine Woellert



FINANCE

HEDGE FUNDS FIND AN ESCAPE HATCH

The loophole: Locked-up funds don't require oversight. That means more risk for investors

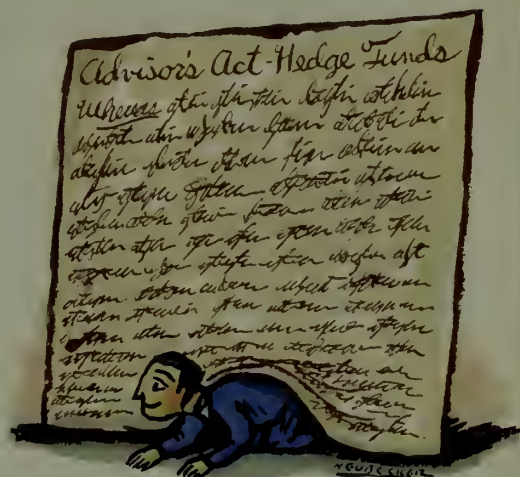
SECURITIES & EXCHANGE Commission Chairman William H. Donaldson recently accomplished a major feat when he got the agency to pass a controversial rule forcing hedge fund advisers to register by 2006. Unfortunately, just weeks after the SEC announced the new rule on Dec. 2, many hedge fund managers have already figured out a simple way to bypass it.

The easy out is right on page 23 of the new SEC rule: Any fund that requires investors to commit their money for more than two years does not have to register with the SEC. The SEC created that escape hatch to benefit private-equity firms and venture capitalists, which typically make long-term investments and have been involved in few SEC enforcement actions. By contrast, hedge funds, some of which have recently been charged with defrauding investors, typically have allowed investors to remove their money at the end of every quarter. Now many are considering taking advantage of the loophole by locking up customers' money for years.

TROUBLING QUESTIONS

SECURITIES LAWYERS say phones are ringing off the hook with questions from hedge funds considering circumventing registration. Some firms have already held small seminars packed with hedge fund managers discussing the potential cost and hassle of registering. Analysts estimate there are over 7,000 hedge funds, with roughly \$1 trillion in assets; many may be looking for an out. Lindi L. Beaudreault, an attorney at Washington-based law firm LeClair Ryan estimates that "one third of unregistered hedge fund advisers are seriously considering locking up their investors' money for two years" to avoid registering.

Hedge funds seeking to skirt SEC registration raises troubling questions given their recent track record. In the last five



years, the SEC has authorized or brought 51 cases against hedge fund advisers for allegedly defrauding investors of over \$1 billion. And some SEC officials are already conceding that the exemption could be problematic. "If we see a significant invasion of the rule, we'll have to rethink," says Paul F. Royce, director of the division of investment management at the SEC.

The SEC did anticipate that some hedge funds would try to take advantage of the loophole. It concluded that investors would have the smarts to steer clear of any fund trying to evade the rule. But it may be tough for investors to distinguish between funds that are lengthening their so-called lockup periods simply to avoid registering, versus those with legitimate reasons for a longer investment horizon, such as a strategy based on turning around troubled companies. Already, investors in 5% of hedge funds with more than \$1 billion in assets, many of which had voluntarily registered before the rule was introduced, have agreed to funds' demands that they hand over their money for two years or more, according to Chicago-based researcher Hedge Fund Research Inc. Still, if hedge fund exceptions become the rule, Donaldson's coup might turn out to be a Pyrrhic victory. ■

—By Emily Thornton
in New York

ACCOUNTING

AUDITORS: THE LEASH GETS SHORTER

Providing tax services to audit clients will no longer be allowed

FOR YEARS, SUN MICROSYSTEMS Inc. looked to its auditor, Ernst & Young International, to provide all manner of advice on other financial matters. But recently the Santa Clara (Calif.) high-tech company has started to shop elsewhere. PricewaterhouseCoopers now handles Sun's internal audit, KPMG International helps test financial controls, and Deloitte Touche Tohmatsu prepares tax returns for Sun's expatriate employees. With new federal rules beefing up the audit process, "it's our firm belief that [Ernst & Young] should focus specifically on the audit," says Stephen T. McGowan, Sun's chief financial officer.

Sun is not alone. After auditors failed to catch financial fraud at Enron and WorldCom (now MCI), Congress ordered companies to quit hiring their auditors for a slew of services, from bookkeeping to computer-systems design. The 2002 Sarbanes-Oxley corporate-reform act left it up to boards' audit committees to decide whether the same accounting firm could provide other services—including tax advice. But with audit committees eager to avoid any chance for conflicts, more companies, from General Electric to Home Depot to American Express, are switching their tax work, too.

Now they have another reason to play it safe. On Dec. 14, the Public Company Accounting Oversight Board proposed stricter curbs on audit firms selling tax services to their clients. The board, created by



McDONOUGH
The PCAOB chief aims to "draw clear lines"

Sarbanes-Oxley, says it wants to ban auditors from promoting aggressive tax shelters to client companies and their top execs. It also wants to keep them from accepting contingent fees, payments

based on a percentage of their clients' tax savings. Also off limits: offering tax services to top company officers. The rules, which must be approved by the Securities & Exchange Commission, "draw clear lines to distinguish inappropriate services that impair auditor independence from permissible services that are not detrimental," says PCAOB Chairman William J. McDonough.

Investors are ahead of regulators. For the past two years, Institutional

Shareholder Services, a proxy-advice service, has urged the investors it advises to vote against rehiring auditors who collect more in consulting fees than they do from the audit and audit-related work. The share of Standard & Poor's 500-stock index companies failing that test fell from 60% in 2002 to just 2% this year.

INCREASED COMPETITION

THE SARBANES-OXLEY restrictions, along with better disclosure, drove much of that improvement, but boards are going beyond the law's strictures. "When in doubt I want to turn away from the audit firm for anything except auditing," says professor Paul R. Brown of the Stern School of Business at New York University, who

also sits on the audit committee of French aerospace company Dassault Systèmes.

The upshot: The average amount a large U.S. company paid its auditor for tax services fell 14%, to \$1.9 million, in 2003, according to a study by Glass, Lewis & Co., a proxy-research firm. Jonathan Hamilton, editor of *Public Accounting Report*, figures tax fees could fall 5% to 10% in 2005 if the SEC blesses the new rules.

Critics have long accused the Big Four firms of underpricing their audits so they can charge hefty fees for consulting. But as businesses pull back tax work and offer it to the competition, rates are falling. Sun, which was paying Ernst & Young \$3.5 million a year for expatriate tax serv-

ices, found Deloitte was willing to do the work for just under \$3 million.

The Big Four aren't necessarily losing out. Audit fees are rising as accountants scrutinize financial statements more extensively, and consulting work taken from the auditor usually ends up at another Big Four firm. Still, second-tier accounting firms and lawyers are gaining. Grant Thornton International, for example, recently took on state and local tax assignments from R.R. Donnelley & Son Co. and Marriott International Inc.

The downside to spreading the consulting work: With only four international firms to choose from, a multinational can't switch auditors without having to reshuffle consultants for its tax, info-tech and human-resources departments. Still, investors will be better off if auditors' independence isn't compromised by fat fees for other services. ■

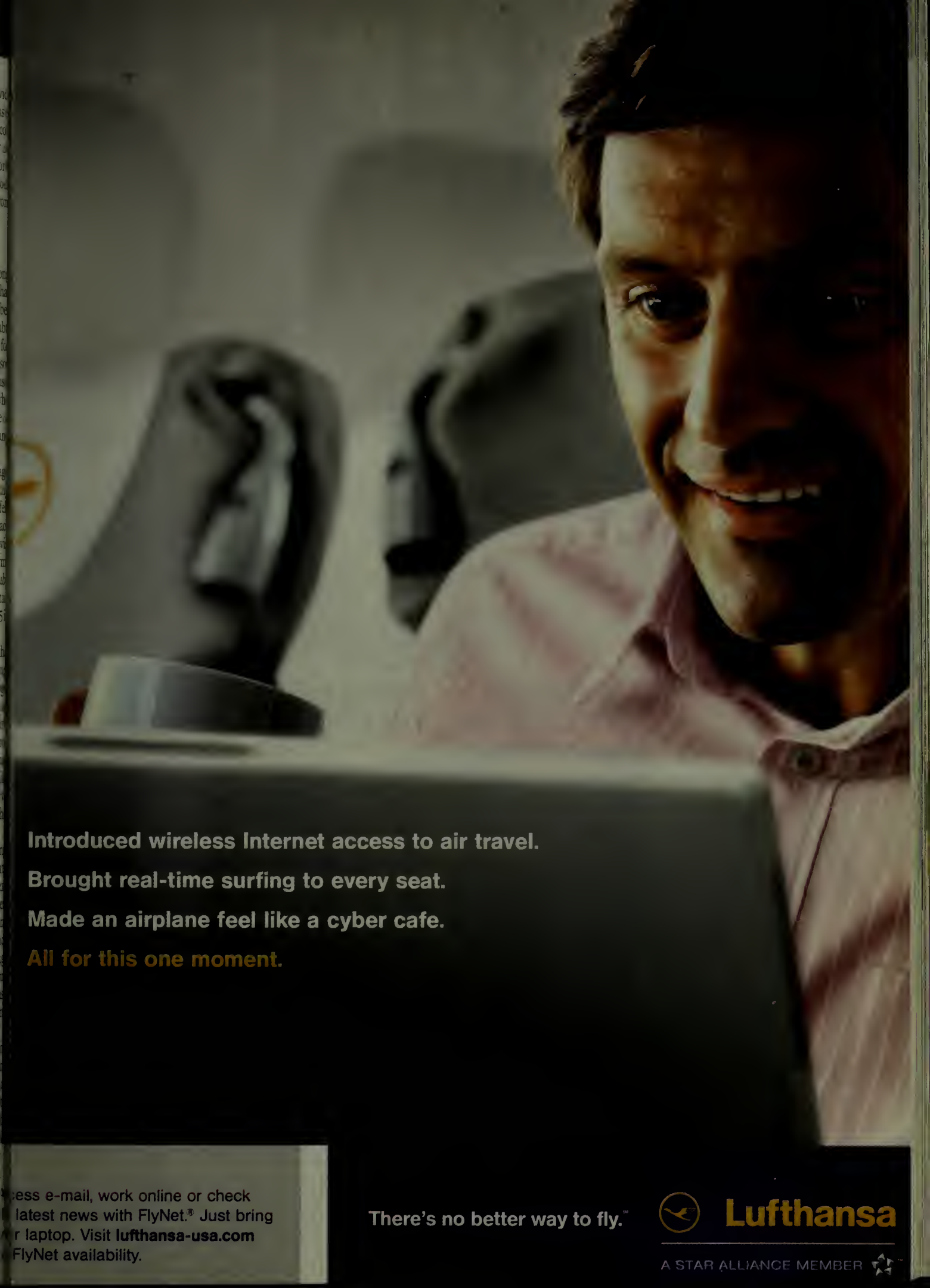
—By Amy Borrus in Washington, with Nanette Byrnes in New York

THE STAT

-14%

Average drop in the amount companies paid their audit firms for tax work, as they've moved to reduce auditor conflicts of interest*

*Based on 2003 filings of 500 large companies. Data: Glass, Lewis & Co.



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A STAR ALLIANCE MEMBER 

EDITED BY ANNE NEWMAN

HEADLINER

JEFF IMMELT



GOOD THINGS COME TO LIFE

For Jeff Immelt, General Electric's time has finally come. After years of telling investors to hang on for 2005, it's finally on the doorstep, and the 48-year-old GE chief is thrilled. In his annual earnings outlook on Dec. 14, Immelt predicted 10% revenue growth for the year and earnings are expected to soar by 13% to 17%. "GE is really the right business for where the world is today," he said.

Along with a stronger economy that should lift GE's long-suffering transportation and energy businesses, Immelt has beefed up GE's presence in such areas as commercial finance, health care, and entertainment. Since taking over from former Chief Jack Welch a few days before the September 11 attacks, Immelt has shaken up the \$134 billion company with massive acquisitions and divestitures, as well as initiatives to get staffers more focused on innovation, globalization, and customer service. Shareholders certainly expected good news, having boosted the stock in the days prior to Immelt's presentation.

-Diane Brady

A BILLIONAIRE FOR BERKSHIRE

Adding another independent voice to its board, **Berkshire Hathaway** directors elected **Microsoft** Chairman Bill Gates to join them. The Dec. 14 move may do little to stem criticism that Berkshire is too insular, since Gates is close with Chairman Warren Buffett. But all but four of Berkshire's 11 directors are now outsiders. The board position is Gates's third, besides seats at **Microsoft** and **Bothell** (Wash.) biotech company **Icos**, which markets the erectile-dysfunction drug **Cialis** with **Eli Lilly**. An **Icos** investor, Gates joined that board in 1990 and as of Sept. 30, his investment arm **Cascade Investment Counsel** held 5.4 million **Icos** shares worth roughly \$129.4 million.

MOPPING UP AFTER AOL



On Dec. 15, **Time Warner** said it had reached a settlement with the Justice Dept. related to accounting issues at its **America Online** unit, agreeing to pay \$60 million in criminal penalties and \$150 million into a shareholder restitution fund. In addition, **Time Warner** submitted a \$300 million settlement proposal, in which it neither admits nor denies guilt, to the SEC. As part of the Justice deal, AOL accepted responsibility for the actions

of its employees, signing off on a statement outlining a scheme to falsely inflate revenue at AOL advertiser **PurchasePro.com**. But the media giant isn't completely free of its legal woes. As part of the deal, it must help prosecutors as they continue to investigate whether to bring charges against individuals. **Time Warner** Chairman Richard D. Parsons signed off on the settlement on Dec. 13. In return, Justice will defer securities fraud charges against AOL and dismiss them in 24 months if the company co-operates fully. At least six AOL employees, who were not identified, were involved in questionable ad transactions in 2000 and 2001, court documents show. **Time Warner** investors still seemed skittish—shares closed unchanged on Dec. 15 at 19.38, after rising 20% since Sept. 30.

GOOGLE HITS THE BOOKS

As competition in the Internet search market heats up, so do efforts by search engines to stand out. On Dec. 14, **Google** announced a partnership with five libraries, including those at **Harvard** and **Stanford**, to digitally scan many of their books, making them searchable on Google. The process, expected to take several years, could be a long-term business opportunity for Google and publishers. Google expects to nestle relevant ads along with book content and then split revenues with publishers.

A POTENT PAIR OF CARDS

American Express struck a deal with **Citigroup** on Dec. 13 to issue high-end U.S. credit cards, uniting two powerful financial-services names. The co-branded cards will be

available by the end of 2005. **Citigroup** is the largest U.S. credit-card issuer and the second issuer after **MBNA** to partner with **AmEx**. Banks have been free to issue **AmEx**-branded cards since an Oct. 4 U.S. Supreme Court ruling ended **Visa International** and **MasterCard International** bylaws banning the practice. **Citibank** will issue the cards and assume credit risk; **AmEx** will process transactions.

ET CETERA...

➤ **Wal-Mart** said it fired three top execs and four others for violating company rules.

➤ **Carl Icahn** took large stakes in the **Hollywood** and **Blockbuster** video chains and is pressing for a merger.

CLOSING BELL

Now that's a hot hand: Shares of **Las Vegas Sands**, owner of **Venetian Casino Resort** in Las Vegas, jumped 60% in first-day trading, to 46.50, making founder **Sheldon Adelson's** stake worth \$14 billion. Sands has a casino license on the booming Chinese island of **Macau**.



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EDITED BY LEE WALCZAK

The Selling of Social Security Reform

IT SOUNDS LIKE A CHALLENGE for Madison Avenue's sharpest wizards: Create a public groundswell for an untested financial product that could entail potentially large risks for customers. Now add this caveat: A botched sales job will backfire and send your stock reeling. That's the dilemma facing George W. Bush as he

launches a marketing blitz to win support for private Social Security accounts.

Advisers say the President, who sees private accounts as essential to his Ownership Society agenda, is determined to make retirement reform his top domestic priority for 2005. But after supporting the concept for five years, Bush has yet to embrace a specific plan or reveal how he will pay for the \$1 trillion to \$2 trillion cost of implementing a quasi-private system.

While the Bushies pore over spreadsheets, opponents—among them Big Labor and the AARP seniors' lobby—have begun a campaign to discredit any blueprint as a health benefit cut for retirees. "This is going to be all-out war," declares Roger Hickey, co-director of the liberal Campaign for America's Future. The result: Corporate backers of privatization are urging the Administration to get off the dime. "You can't afford to sit on your hands while the opposition builds up a head of steam," frets the business lobbyist.

White House pols believe that skillful marketing will trump apocalyptic opposition rhetoric. Its three-stage sales plan was kicked off with the President's Dec. 12 radio address, followed by a speech planned for his economic summit on Dec. 5. In Phase One, Bush will try persuading Americans that Social Security will face a crisis of insolvency by 2018 as baby boomers retire. "The math is undeniable," says White House Communications Director Dan Bartlett. "We cannot meet our obligations to future generations."

Bush will argue that private accounts will increase workers' return on their pay-

roll-tax payments. To counter Democratic charges that his plan will result in future Social Security cuts of up to 40%, the Prez is pledging that no senior or worker near retirement age will lose a penny of benefits. And in a technique used successfully by the 2004 Bush campaign to bypass the media elite, Administration officials will fan out across the country to emphasize the benefits of the plan—especially to young people, working women, and minorities.

Airwaves War

PHASE TWO INVOLVES an airwaves war costing more than \$40 million, largely underwritten by the business community. The ads will trumpet the economic benefits of private accounts and harp on the dire consequences of inaction.



SALESMAN-IN-CHIEF Bush will introduce the plan in stages

Finally, in Phase Three, a concrete reform plan will take shape as Bush begins to detail how big he thinks the accounts should be—and how much federal borrowing might be needed to pay for them. Republican Hill leaders will step up their ef-

forts to recruit a few Democrats to the reform camp to give the effort a patina of bipartisanship.

Already, however, Bush is on the defensive against Democrats who say he's playing a shell game. "They call it a crisis. They have no plan. It sounds like Iraq," says Representative Rahm Emanuel (D-Ill.). But the GOP is girding for battle, and the stakes go beyond pension reform: Conservatives see Social Security privatization as a realigning issue that will help build a vast investor class and nurture a new generation of Republicans. That will make the fight even fiercer. ■

—By Richard S. Dunham

CAPITAL WRAPUP

THE TELECOM BATTLE AHEAD

INCOMING SENATE Commerce Committee Chairman **Ted Stevens** (R-Alaska) and ranking member **Daniel K. Inouye** (D-Hawaii) are preparing to rewrite the much-maligned 1996 Telecommunications Act in 2005. The kickoff event: a "listening tour" to chat with companies, state regulators, and consumer advocates from New York to Honolulu. The two senators from the most far-flung states want to preserve and even explore expanding universal service—the subsidies that keep phone rates affordable for rural Americans—in the coming era of Internet phoning. Few voice-over-Internet providers pay into the fund now—a gap that rural lawmakers want to close before the spread of Web calling undermines the subsidies. One hurdle to the planned rewrite: House Energy & Commerce Committee Chairman **Joe Barton** (R-Tex.), who opposes new taxes or regulation of the Internet.

AT THE SEC, SCORE ONE FOR WALL STREET

IN A MOVE that will please Wall Street but disappoint small investors and financial planners, the **Securities & Exchange Commission** is expected to adopt a rule that gives brokers more leeway to sell investment advice for a fee without meeting the same standards as financial advisers. But the agency is likely to require brokers to disclose when they get extra pay to favor certain mutual funds or other financial products in their recommendations. The SEC may try to placate consumer advocates by promising a wide-ranging review of separate rules for brokers who call themselves advisers.

JAPAN

HONDA'S FIRST U.S. BRUISER

With the Ridgeline, it jumps into a crowded—and lucrative—market

IT BOASTS A CHISELED PHYSIQUE meant to appear carved from a single block of metal. It has four-wheel-drive, a hardy V-6 engine, a 1.5 meter-long open cargo bed in back, and a decidedly outdoorsy name—the Ridgeline. The manufacturer? Not Ford, Chevrolet, or Dodge. Try Honda Motor Co.

Honda? For years the Japanese company has prospered by churning out solid and reliable compacts, sedans, minivans, and small sport-utility vehicles. Truth to tell, the Honda lineup was a trifle boring, and in the U.S.—the company's biggest market—pickups weren't part of the mix. The top Japanese management thought pickups didn't fit the brand's image.

Today, though, Honda is looking to the spunky Ridgeline to help revive its flagging fortunes in North America. Sales will begin in the spring after a splashy kickoff

with a pair of 30-second spots during the Super Bowl on Feb. 6. Critics snicker that the Ridgeline lacks a V-8 engine, can't tow big trailers, and shares some of its underpinnings with a minivan. Then there's the matter of the four-door cabin, roomy enough to haul the whole family.

But the bold new addition to Honda's lineup is key to its bid to retain once-loyal drivers fleeing the brand for beefier vehicles. Though Honda hasn't announced pricing, the vehicle will compete with the Toyota Tacoma, Ford Explorer Sport Trac, and Nissan Frontier, all of which cost under \$30,000. "Honda customers are typically buyers of compacts and minivans, but now they're clamoring for pickups," says Takeo Fukui, who stepped in as Honda's president 18 months ago. "The Ridgeline helps us meet that need."

Honda could use a pick-me-up. It's not in desperate shape, but it's clearly losing ground to rivals Toyota Motor Corp. and Nissan Motor Co. in the all-important U.S. market. Even as the other two burn rubber in North America, Honda expects unit sales there to grow just 0.1%, to 1.56 million vehicles, for the year ending in March. In the six months ended on Sept. 30, it posted a 7.7% drop in North American auto revenue, to \$18 billion. One big reason: Honda doesn't offer full-size SUVs, rear-wheel-drive luxury cars, or pickup trucks—among the most profitable segments of the U.S. market. Nissan and Toyota are competitive in all three categories.

That spells trouble for



RIDGELINE
CONCEPT

Growth Needs a Pickup

	NORTH AMERICAN SALES 2004*	GROWTH OVER 2003	N. AM. AS % OF TOTAL UNIT SALES
HONDA	1.56 million	0.1%	49%
TOYOTA	2.22 million	5.7%	31%
NISSAN	1.30 million	14.0%	39%

Data: Company reports

FUKUI He ran Honda's U.S. unit and R&D before becoming CEO

Honda. Although the company's car sales in Japan jumped 14.2% in the first half, to \$6.9 billion, North America is where the action is. The region made up 80% of Honda's \$4.5 billion in 2003 profit. Honda's poor showing in the U.S. is aggravated by the yen's weakness against the dollar, which is eroding earnings. Honda expects income to drop 3.7% this year, to \$4.3 billion on sales of \$84.4 billion. Honda "has lost a bit of its steam," says Chrysler Group CEO Dieter Zetsche.

Honda isn't pinning all of its hopes on the Ridgeline. Fukui also plans to introduce a revamp of Honda's bland Civic compact next year. Sales of the car in



growth—and profit—potential. While hybrids have carved out a trendy and growing niche, Americans show little sign of abandoning gas guzzlers, and margins on pickups can be double those for compacts such as the Civic. Designed and engineered in North America, the Ridgeline is a daring first step into a highly competitive market the company has long avoided. The project was greenlighted in May, 2003, while Fukui served as head of research and development, and just a month after Honda announced that he would become president. While it's built with a half-ton payload capacity, the vehicle is designed to appeal to city slickers with its five roomy seats, garage-friendly height, and extras such as removable Maglite flashlights in front door panels. "We're very excited" about the Ridgeline, says Adam Dungan, sales manager at Park Honda in Akron. "It's going to open up another area for customers who might be thinking about buying" rival models.

The Ridgeline could also serve as a test case for Honda as it tiptoes toward the full-size truck segment. Should the Ridgeline prove popular, it will strengthen the hand of a faction inside the company that favors a shift toward larger pickups and SUVs. Such a move would eat up some \$1.5 billion in development costs—a big bill for Honda, which is comparatively small in the auto world and renowned for its frugality. The company won't disclose the cost of designing the Ridgeline, but it was able to limit the expense by using the same platform and factories that produce the Pilot SUV and Odyssey minivan. And the engine is based on the 3.5-liter V-6 powertrain used for those vehicles.

The next step up—a full-size truck or SUV—would require a bigger and costlier V-8 engine, which Honda doesn't make. "If the Ridgeline does particularly well, it might change some thinking among Honda's brass—though probably not overnight," says Merrill Lynch & Co.

Five roomy seats and nifty extras aim to please city slickers

analyst Chris Richter in Tokyo. Critics of the idea say the money would be better spent elsewhere. They argue that since full-size vehicles sell well only in the U.S., the project would drain resources from faster-growing markets such as China, and the trade-off isn't worth the cost. Even as Honda's earnings slid in North America

during the first half, profits rose in Asia and Europe, according to research by Nikko Citigroup. And some observers even wonder whether the Ridgeline will be the hit in the U.S. Honda wants it to be. The Ridgeline could well appeal to Honda fans, "but will it bring new people to the brand? No," says Wesley R. Brown, an analyst at Los Angeles automotive consultant Iceology.

Fukui, who headed Honda's American operations from 1996 to 1998, may be trying to placate the critics. He says he's in no rush to jump into full-size pickups, which he amiably dismisses as "stupid-big." But if Americans warm to the Ridgeline, Fukui might yet find a place in his heart—and Honda's lineup—for trucks, even stupid-big ones. ■

—By Chester Dawson in Tokyo, with David Welch in Detroit

Safety First

Can Honda become the Volvo of Asia? Honda thinks so—and it's pushing safety as a major selling point. Last year it opened a \$30 million test facility in Ohio and is now offering more **premium safety devices** as standard equipment. "Honda used to trail Mercedes-Benz and Volvo in safety, but we're doing a lot to catch up," says President Takeo Fukui. Here are a few key initiatives:

■ In Japan, Hondas have computers that hit the brakes if sensors detect an imminent crash and beep and flash if a drowsy driver strays from his lane.

■ Its Legend sedan, sold in Japan, has an infrared night-vision screen that pops up on the dash and can outline human forms in the darkness.

■ By 2010, Honda will design the front ends of all its vehicles to absorb more of the impact of a crash—and do less damage to the other driver's car.

■ By 2007, Honda plans to make antilock brakes and side-curtain airbags standard equipment on all models sold in the U.S.

North America have declined 8.7% from their peak in 2001, to 300,011 last year. The company is keeping details about the new model, due out next fall, under wraps, but execs promise a sportier engine and flashier styling. Unofficial spy shots depict a low-slung two-door car with a sloping hood—very unlike the uninspiring Civichouette of today. The new Civic follows the December launch of the hybrid version of the Accord sedan, to rival the popular Toyota Prius. The new car has wowed the auto press by getting 37 miles per gallon in highway driving and yet zipping from 0 to 60 mph in only 6.7 seconds. The Ridgeline, though, has the biggest

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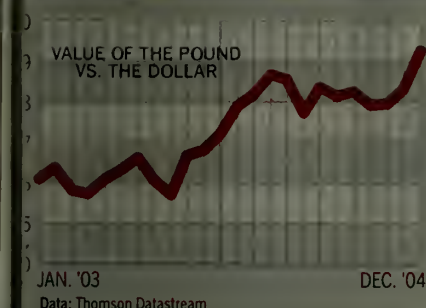
BRITAIN

THE POUND IS STERLING

Its strength is fueling spending—and growth

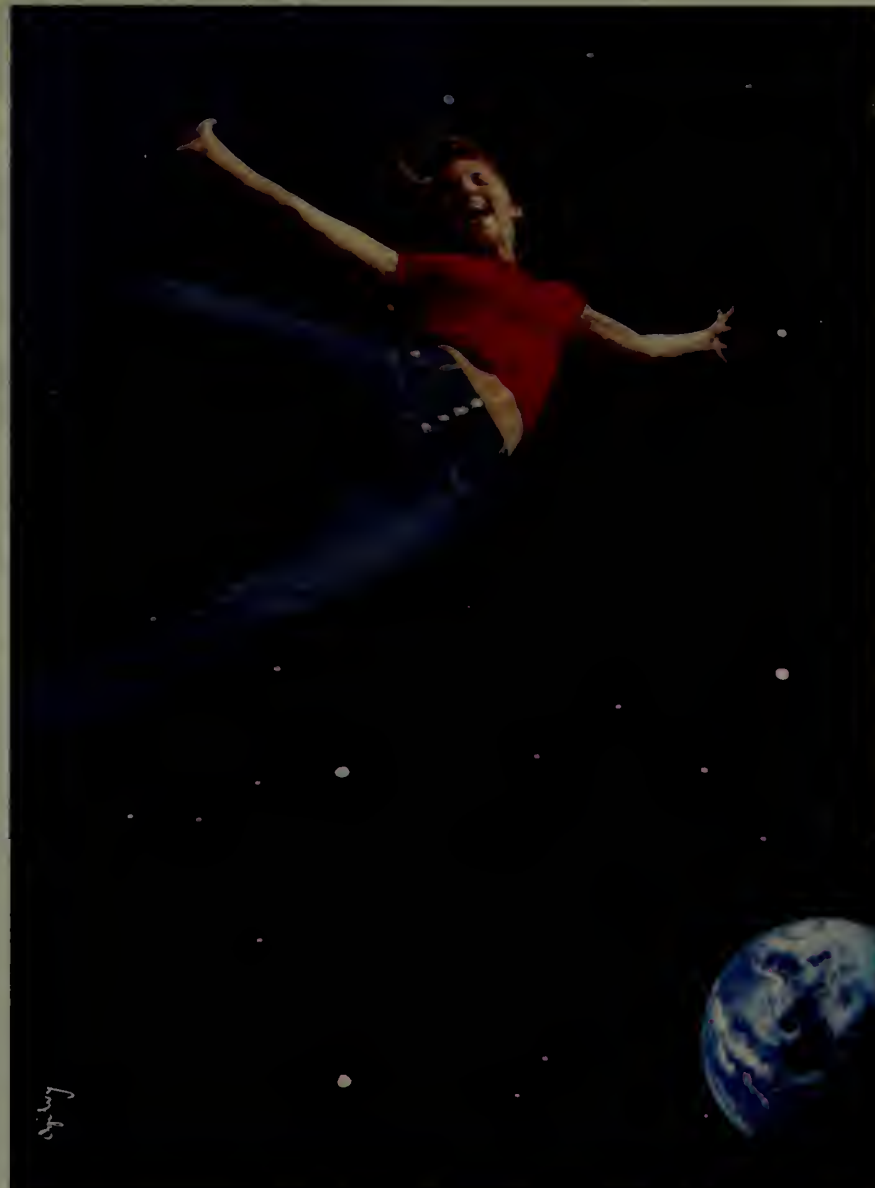
THE EURO IS UP AGAINST the dollar—way up. And that has euro-zone officials complaining that Washington isn't doing enough to hike the greenback. But another currency has taken off, too. The British pound rose to almost \$2 in early December, its highest level in 12 years, before slipping a bit to its current \$1.94. Most Brits, however, seem to like their currency strong. How so? Britain's flexible economy is adapting fairly well: Growth should hit 3.7% this year and 3.1% in 2005. The strong pound has made cheap Asian

MUSCULAR CURRENCY



goods even cheaper, driving up retail sales. The muscular currency has also pulled in foreign bond investors. And the pound has made the export of services such as consulting, accounting, and insurance brokerage more lucrative since these are premium products that remain in high demand. True, some manufacturers that export to the U.S., such as Ford Motor Co.'s Jaguar, are suffering. But the pound's impact on most manufacturing is muted since Britain's main market is the continent, not the U.S., and the pound is not gained against the euro. Europe's other strong currency, it seems, isn't inflicting much pain at all. ■

—By Laura Cohn in London



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WILL MICROSOFT WRIGGLE FREE AGAIN?

Brussels legal circles are betting the giant will win partial or even complete relief

IT WILL BE THE TECH sector's most closely watched court ruling since U.S. Federal Judge Thomas Penfield Jackson ordered the breakup of Microsoft Corp. in June, 2000. On or before Dec. 20, Judge Bo Vesterdorf, president of the European Union's second-highest court, is expected to issue a decision in the six-year legal battle between Microsoft and the European Commission. The Danish jurist must decide whether the remedies ordered by the EC in its Mar. 24 antitrust decision against the U.S. software giant should go into effect immediately or be postponed, potentially for years, pending Microsoft's appeal of the case.

At first glance, this might seem like a mere turn of the screw in a protracted legal process. But Vesterdorf's ruling will be the first time in the history of Microsoft's European antitrust misadventure that anybody outside the commission itself has passed judgment on the merits of the case. Under the stern guidance of then-competition czar Mario Monti, the commission ordered Microsoft to pay a \$611 million fine, offer a version of Windows with its Media Player application stripped out, and disclose secret protocols used for communication among Windows servers and PCs. If some or all of these demands are put on hold by Vesterdorf, the commission's position could be badly



HALLS OF JUSTICE
The longer the process, the better for Microsoft

Microsoft

Only one major tech player is still in the suit. The others have settled

ly weakened. "It would be crazy for them to go full steam ahead," says Lars H. Liebler, antitrust counsel to CompTIA, a pro-Microsoft industry group. If the commission backs off as a result, Microsoft could once again wriggle free of a seemingly damning legal setback—just as it did after Judge Jackson's ruling was overturned, and Microsoft settled with the Justice Dept.

To be sure, the software maker faces high hurdles to win a stay. Microsoft must demonstrate either that the commission's ruling is likely to be overturned by appeals courts on the merits or that implementing the remedies will cause irreparable harm to the company. That's no easy feat.

Vesterdorf's European Court of First Instance has granted stays in only 17% of the cases before it. "There's a great deal of deference given to the commission by the court," says a source close to Microsoft. Vesterdorf gave no indication of his leanings during two days of hearings this fall. But in 2001 he granted a stay in another case that involved mandatory disclosure of intellectual property.

Despite the odds against a stay, the betting in the Brussels legal community is that Microsoft could win partial or even complete relief. Vesterdorf might, for instance, hold off on unbundling Windows Media Player because he thinks the commission's legal case is weak. Or he could suspend the order to disclose server software protocols on the basis of irreparable harm, reasoning that Microsoft would have no way to reverse course if it eventually won an appeal.

NEW MANAGEMENT

IF VESTERDORF'S ruling casts doubt on the commission's decision in any way, Microsoft will seize on it as an opportunity to try to craft a settlement. Odds that a compromise could be struck have improved. In recent months, Microsoft has negotiated private settlements with four of the five major rivals who supported the European case: AOL Time Warner, Sun Microsystems, Novell, and the Computer & Communications Industry Assn. And there's a new EU Competition Commissioner in place: Neelie Kroes, the Dutch businesswoman who took over from Monti last month, is clearly less invested in the Microsoft matter than her predecessor was and might want to clear the decks to focus on newer cases. A commission spokesman wouldn't comment on the Microsoft case.

If all else fails, Microsoft has time on its side. Windows Media Player is already used by a majority of Europeans, while Microsoft's server software has knocked Novell's alternative out of the ring. If Microsoft gets some or all of the commission's remedies stayed, its legal travails in Europe could draw to a rapid close. And even if they don't, the fast-moving tech sector could render the whole issue moot by the time the wheels of European justice have run their course. ■

—By Andy Reinhardt
in Paris

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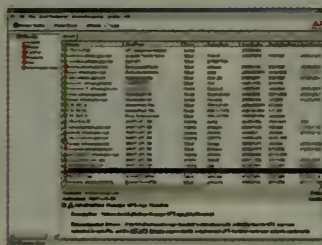
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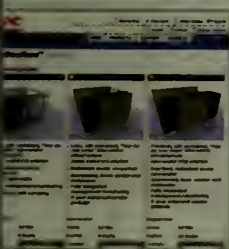
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COMMENTARY

BY CAROL MATLACK

Is Airbus Caught in a Downdraft?

Cost overruns on the A380 and a new midsize jet will hurt the bottom line

IT'S SUPPOSED TO BE the moment of triumph for Airbus Chief Executive Noël Forgeard. On Jan. 18 a star-studded crowd, including four European heads of state, will gather in Toulouse, France, as the first completed airframe of an Airbus A380 rolls out of the factory. The biggest passenger plane ever built, the doubledecker A380 is on schedule to enter service in early 2006. Forgeard, 58, may even have a new title by then. He's being backed by the French government for a big promotion, to co-CEO of Airbus parent European Aeronautics Defence & Space Co. next year.

But two events have cast a shadow over both Airbus and Forgeard. On Dec. 10 the EADS board O.K.'d plans for a new midsize jet, the A350, that Airbus wants to put in service in 2010 to counter Boeing Co.'s superefficient 7E7. Although Airbus ear-



lier hinted at a modest retooling of its existing A330 to match the 7E7, the A350 is a more ambitious overhaul that will cost at least \$5.3 billion, but still not yield all the advantages of a brand new design. Then, on Dec. 12, Forgeard told a French newspaper that the A380 is running as much as \$2 billion over budget.

These developments could spell big trouble. Startup costs for the A380 were expected to drop off sharply from a peak of \$1.6 billion this year, to less than \$700 million by 2007. Analysts thought Airbus would be able to tap at least \$2 billion in additional cash flow over the next three years, enough to finance a modest A350. Now investors fret that paying for two planes will squeeze EADS' bottom line. The company's shares fell 4% on Dec. 13 after EADS predicted a 2005 operating profit of \$3.2 billion, about 15% below analyst expectations. The prospect of a management reshuffle only adds to the nervousness. "The Air-

bus team has its hands full, so why change horses now?" said Lehman Brothers Inc. analyst Joseph Campbell.

Now that Airbus can't finance the A350 out of cash flow, it will almost certainly seek sizable loans from European government. That move will raise the temperature of an already heated U.S. European dispute over aircraft subsidies. Although Airbus has received billions in such loans under a 1992 bilateral agreement, the U.S. maintains the European planemaker no longer needs help because it has pulled ahead of Boeing. Washington is threatening legal action before the World Trade Organization. "We're serious about the litigation option," U.S. Trade Representative Robert Zoellick told a *BusinessWeek* conference in Paris on Dec. 10.

The risks don't end there. Industry watchers think the A350 will doom one of Airbus' best-selling planes. The A330, which seats 250 to 350 passengers, is the closest aircraft in Airbus' line up to the 210-to-250-seat 7E7. As recently as this fall, management was arguing that the A330 could hold its own against the 7E7 without major modifications. But now Airbus proposes a ambitious makeover, with a more efficient engine and a new wing. "It's going to either cannibalize or completely destroy the

Airbus is likely to seek new loans from European governments

market for the A330 in just a few years," says Doug McVitie, a Scottish aerospace analyst who once worked at Airbus. Boeing is exultant. "By offering the A350, they have thrown their 20-year product strategy out the window," says Randy Baesler, Boeing's vice-president for marketing.

Certainly, the picture's not all gloomy. Airbus is set to deliver 32 planes this year, compared with 28 for Boeing. Forgeard says he plans to achieve \$2 billion in cost saving from 2004 through 2006, mostly

due to better efficiency: "Overall we have margins, before R&D that are about 5 percentage points higher than Boeing's."

Yet Forgeard's 11th-hour challenge to the 7E7 suggests that Airbus underestimated the market potential for a more efficient midsize jet. As for the A380, Forgeard didn't make clear that even before the recently acknowledged cost overruns, development costs had soared far above the original \$10.7 billion estimate, as the dollar has declined 30% against the euro since the project's start in 2000. On Dec. 14, EADS finally fessed up. The total price tag, including the overruns is at least \$15.9 billion. Forgeard has built a powerful company in Airbus. But these aren't the kinds of numbers investors like. ■

BusinessWeek online

For an interview with Airbus CEO Forgeard, go to www.businessweek.com/extras

SECURITY HOLES

aniel Katz-Braunscheig is what has come to be known as a "White Hat," a skilled hacker who companies pay to try and break into their systems and report back. And his favorite way to get into an enterprise network these days is the networked fax or printer.

"I don't think it's understood at all that these boxes have an embedded version of an operating stem. It's a little workstation, a little server," Katz-Braunscheig says, adding that these rarely feguarded peripherals are a wonderful way to break into a network.

But the biggest security threats have almost always been those that are not seen. They are her not known to most IT security managers or are known but ignored. In almost ery instance, threats are the unintended result of improving business operations. tranets and supply chains, for instance, help businesses, but open doors to angers. PDAs, laptops and high-end cell phones boost employee productivity, it they also compromise companies by allowing data to be removed from the curity of the corporate environment.

Often, it's the innocuous new feature or capability that inadvertently opens up e biggest security hole. With increases in both capabilities and intelligence, ipherals can now remember data and give full network access to anyone. But they main relatively unprotected. And while it's well known that the convenience of a reless network makes data available to data fiends who want to scan the airwaves, l devices are still connected to the network. Who would suspect the mild-annered copy machine, scanner, fax or printer as a threat?

Toiling at home is a convenience to the worker and a benefit to the company. But the lax security of a home network compromising data? Could it allow a Trojan horse get inside an employee's laptop, waiting patiently for the next connection to the rporate LAN when its nefarious mission can begin?

For that matter, how safe is a hotel's high-speed connection or one at an airport, in station or client's office? Are you sharing more than you intend to when you try to download mail at a Starbucks? And how secure is the data on your PDA and your cell phone?

"What we have here is the vanishing perimeter," says Jason Wright, a security industry analyst r Frost & Sullivan. "Companies today have so many types of people coming in from so many fferent entry ways. Controlling what is done inside the network is becoming an exponentially more fficult task."

The Trusted Community

he increasing popularity of the extranet is a major point of vulnerability. Traditionally, IT managers sign a top priority to keeping intruders off the network and spend much less time and money aking sure that their authorized users don't exceed their network privileges. In other words, they ake sure the front door is locked with a top-notch deadbolt and hope that family members and ernight guests don't rob them.

Technology
advances and
more efficient
partner
networks have
inadvertently
generated



major security
holes. Here's
a look into
how to protect
the network.

It's an illogical position, given the well-known fact that the vast majority of information thefts and sabotage are masterminded and/or executed by insiders. But it's always easier to scare management with threats of terrorists, ill-intentioned hackers and corporate spies than it is to tell them they can't trust their own people.

The popularity of extranets is making the "just secure the front door" approach (typically firewalls and VPNs) even less logical. Not only does the list of people who have some authorized access to a company's network include that company's employees and contractors, but it also includes the employees and contractors of distributors, suppliers and major customers. And depending on the company's e-commerce approach, that list may even include not-so-major customers.

Lots of Trust

For a large company, the number of people who have at least some authorized access can easily exceed one million. That's a pretty big trusted community.

And that large a community can cause problems. Today's technology is allowing much greater and deeper access. To the extent that access improves efficiencies and time-to-market, it's a very good situation. But those improvements are leveraging the ability of your partners to be able to do more. And that's widening the security hole.

This blurring of the distinctions between groups of people considered safe and unsafe is a major crack in the proverbial armor of a typical corporate security strategy. Corporate security managers today "still live by the pyramid security model, which holds that most of the security can be handled by putting a thick border between the inside and the outside of their company," says Sachar Paul, chief security officer for SAP.

But with managers and employees alike enjoying mobile/pervasive computing, such distinctions are becoming pointless. Whether it's accessing e-mail while on an

overseas trip, using a RIM BlackBerry cell phone/PDA hybrid, enhancing a company's supply chain or using radio frequency identification (RFID) or even a camera-equipped cell phone. "there is no longer a clear separation as to whether people should be considered inside or outside. The model of perimeter security is not appropriate anymore," he says.

Paul argues that security must move to a permissions/privileges approach, where both inside and outside people are considered threats, and they are granted the least-level permission possible to do their jobs. This is the need-to-know approach.

Internal Controls

Beyond being potential security threats, employees also are a company's first line of defense. If they are reckless with their passwords or do not take reasonable steps to preserve both their data and their access to the network, it can undermine the most elaborate security defenses.

"You have got to look at internal controls," says Trevor Healy, vice president of Payment Services for VeriSign. "You can build as much external protection (firewall and VPN) as you wish, encrypt data, etc., but if your employees do not take basic measures, it won't help."

Healy says Sarbanes-Oxley reviews allow companies to audit systems and clean up network access, such as former employees and those employees who have excessive, unnecessary access.

"In many cases, companies are not keeping internal controls implemented," he says. "We must educate the user inside the company." Healy gave as an example companies that offer internal Wi-Fi access too easily and frequently.

Matt Dircks, vice president of security products for NetIQ, says companies drop their guard when users are inside the network, which he says is a terrible mistake. "I call it the egg roll security approach: It's hard on the outside and soft on the inside," he says, pointing to lenient systems about permission/privilege levels and the failure

How Secure Do You Need To Be?

Standard Level

Who should use it?

- Human Resources
- General Office

Benefits

- Confirm user access
- Protect user output

Application

- Secure the user (user authentication, account codes)
- Secure the output (confidential/PIN printing)

Heightened Level

(Includes Standard Level)

Who should use it?

- IT Departments
- Accounting
- Financial
- Insurance
- Healthcare

Benefits

- Eliminate the latent document image
- Safeguard user access

Application

- Secure the image data (data security kit)
- Secure the network access (IP/MAC filtering)

Optimum Level

(Includes Heightened Level)

Who should use it?

- Federal Agencies
- Military
- Research & Development
- Legal

Benefits

- Audit user activity
- Protection of documents even after distribution

Application

- Secure the audit trail
- Secure the document rights

Source: Sharp Electronics

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to deactivate outdated accounts.

Of all the security risks, probably the most powerful and least recognized threats come from seemingly mild-mannered devices that have been around networks for years: printers, fax machines, scanners and copiers.

The problem is these devices quietly

Indeed, those networked peripherals pose a much greater threat than divulging to strangers what you've been scanning. Given that they are not typically seen as a threat, these devices rarely are protected. And yet they now have full network access and the brains—CPU and RAM—to use it.

manufacturing control system to a data network "make good business sense," he says, "but you're sharply increasing the probability that someone will be able to get into your plant-floor network."

The tendency to make accessible to outsiders systems that were never intended to be accessible to outsiders is the problem. Travis has some favorite—and frightening—examples: In 2003, the Slammer worm infected a telecommunications provider's network, which prevented communications to and from a utility's substation Supervisory Control and Data Acquisition (SCADA) control system. This in turn rendered the substation inoperable for about six hours.

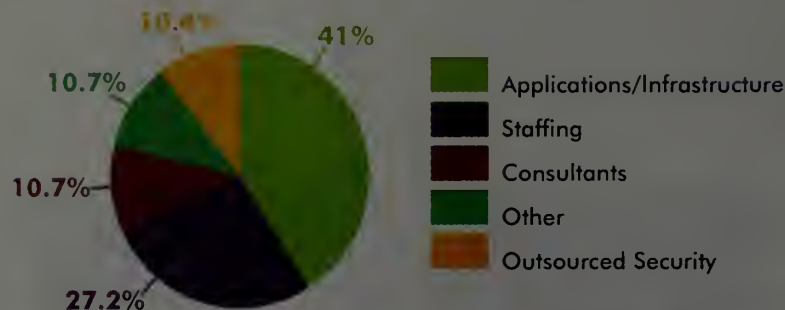
The Nuclear Regulatory Commission confirmed that in January 2003 the MicrosoftSQL Server (Slammer) worm infected a private computer network at the Davis-Besse nuclear power plant in Oak Harbor, Ohio, disabling a safety monitoring system for nearly five hours. In addition, the plant's process computer failed, and it took about six hours for it to become available again.

Travis also cites a hacker in Australia who used a radio transmitter to hack into the controls of a sewage treatment system and release about 264,000 gallons of raw sewage into nearby rivers and parks.

"The implication of the security attack changes radically," he says. "If someone gets in and steals financial data, that's bad. If someone gets in and starts opening and shutting valves, it could be catastrophic." ■

What Are The Biggest IT Security Hurdles?

Here is how IT managers rank the top IT security challenges.



Source: AMR Research

have become much more sophisticated in recent years. Copy machines can now remember hundreds of documents for an extended period, which puts the information-confidentiality threat much higher than remembering to remove the original. The copier will remember your original long after you've left and will share it with anyone it thinks is authorized. Depending on settings and equipment, these machines are not always that picky about choosing those they consider authorized.

"Every printer today has a CPU and it is as vulnerable as any other computer on the network. But people aren't even considering the print controller a problem," says Edward McLaughlin, president of Sharp Document Solutions.

VeriSign's Healy says he is concerned about peripherals with network access providing easy access to intruders, but stressed that a properly configured and managed network can indeed protect itself. "If network security settings are set up correctly, that unauthorized printer access attempt should set off an alarm. The question is whether someone is actively watching."

Changing Security Implications

Lance Travis, a vice president of security research at analyst firm AMR Research, says his favorite overlooked security risk happens after a major supply-chain system enhancement. Supply-chain networks that connect a company's

Security resources

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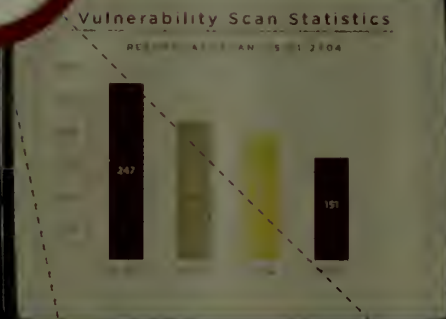
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Using NetBIOS from a wind	10.3
General	6.2
IIS 5.0	3.8
Misc. 1	2.8
CGI abuse	2.5
RDS/MDAC (MSADP)	2.3
CGI	1.8
	1.8



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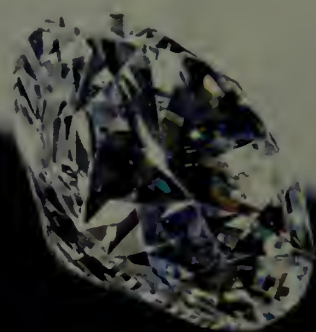
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2004 wasn't exactly easy, but this year will be tougher. Get set for big challenges
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THE BEST PLAYS

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SMART STRATEGIES

To rack up serious returns, you will need to be considerably more creative
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MINING THE NUMBERS

Our scoreboard can yield investment gold. Here are eight ways to pan for it
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Calling 2004 right was no small feat. And 2005 promises a whole different climate

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Higher interest rates. Lower earnings growth. Suddenly, cash-rich, old-reliable companies are the place to be

LAST YEAR'S CHAMP >> P. 76

Kim Goodwin's calls were amazingly on target in 2004. Look out: For 2005, she sees modest gains at best

FEARLESS FORECASTERS >> P. 78

The 67 market analysts we polled see single-digit gains. Also, they say, more investment abroad wouldn't hurt

WISDOM OF THE GURUS >> P. 80

Sit at the table with a panel of Wall Street industry veterans and hear where the smart money is headed

FIVE WILD CARDS FOR 2005 >> P. 84

What could throw the economy for a loop this year? Oil, the dollar, inflation, housing, and unrest abroad

A CLOSE CALL >> P. 90

PNC's Stuart Hoffman aced last year's *BusinessWeek* economic survey. What does he expect this time?

THE BUSINESS CLIMATE >> P. 92

The 60 top economists in our survey see strong enough growth to support spending and hiring gains

JACK BLACK



The Watchword For the New Year Is Quality

With interest rates rising and earnings growth slowing, solid, cash-rich companies don't seem quite so dull. **BY MARCIA VICKERS**

IF YOU WERE LOOKING FOR excitement in 2004, you wouldn't have found much in the stock market. Truth is, the Presidential debates ("I own a timber company? That's news to me.") and the sports steroid scandal were much more riveting. True, some pockets percolated—like energy and industrials such as steel. And some techs like Google, Apple Computer, and eBay became market darlings. But overall, sky-high oil prices, turmoil in Iraq, rising interest rates, and a weak dollar kept stocks down and out most of the year. The big thrills came after the Nov. 2 election, when stocks staged a Red Sox-like comeback. They've managed to hold on to most of those gains, and the

Standard & Poor's 500-stock index will probably end the year up 8%.

The not-so-great news is that stocks are apt to be lackluster the first half of 2005. The strategists we polled for our "Fearless Forecast" (page 78) think next year the S&P will return single-digit gains—around 8% again. The Federal Reserve is expected to keep hiking rates. Given the U.S. trade and budget deficits, the dollar isn't likely to rebound. Oil prices may stay high, especially now that OPEC is cutting output. And profit growth will probably start to decline next year. As a result, most Wall Street strategists see few catalysts that could drive stocks up in the next few months. Says Thomas McManus, U.S. equity strategist

Smart Moves

Sluggish profits and rising rates may be a drag on the market. Here's how discerning investors could do well:

SEARCH OUT HIGH-QUALITY companies with consistent earnings growth that trade at a discount to their peers

LOOK FOR COMPANIES with strong cash flow—which often means a company's profits will increase. It could also presage stock buybacks and dividend hikes

IDENTIFY COMPANIES that are increasing their dividends, especially those with growing profits and strong balance sheets

TAP INTO MULTATIONALS that will benefit from a weak dollar

FIND CONTRARIAN PLAYS in fields that the conventional wisdom says have had their day, such as financial stocks and pharmaceuticals



at Banc of America Securities: "We expect smaller gains in 2005 and believe investors are overlooking significant risks such as inflation." He recommends 55% allocation to stocks. A year ago, it was at 70%.

So how to play the market? A good strategy is to continue to migrate into quality stocks—companies that have consistent earnings growth and strong balance sheets with low debt and healthy cash flow. If they're trading at a discount to their peers, all the better. Quality stocks are even more important as earnings growth slows. Corporate profits rose 19% this year, but in 2005 they're expected to be up only around 11%. With interest rates on the rise, solid, cash-rich companies are likely to outperform cash-poor ones. Weaker companies need fresh capital to stay in business, but higher rates make capital more pricey, putting a damper on their earnings.

Although stocks aren't overvalued, they're not cheap. The S&P is trading



ound 17 times expected earnings over the next 12 months. That's more than the average 15 over the last half-century. Still, many quality stocks—especially utilities and consumer staples—are trading at lower price-earnings ratios than the market. Investors have bid up low-quality small-caps and fast-growing tech stocks—while largely ignoring safer, under stocks. Richard Bernstein, chief U.S. strategist at Merrill Lynch & Co. and one of our roundtable panelists (page 80) advises investors to search for companies with the steadiest growth rates—around 10% to 15% a year, rather than highfliers with often unsustainable 25% to 30%.

SMALL-CAP SPUTTER?

TO FIND SUCH COMPANIES, look beyond smaller-caps and mega-caps, which are richly valued, and focus on mid- to large-cap stocks. Small-caps, which have outperformed large-caps over the past four years, may start to run out of steam in 2005. They tend to outperform in the

early stages of an economic upturn, when they get an easy oomph from increased liquidity. But now that the recovery is maturing, the “I” word (inflation) is heard, and growth is slower. So strong companies matter more than ever. Our “Fearless Forecast” strategists like the energy sector best, followed by technology, industrial cyclicals, and health care.

Companies that raise their dividends are often good picks. They usually have strong cash flow and solid earnings. What's more, dividend-paying stocks outperform nonpayers over the long term. And companies with the highest dividends tend to outperform others. According to a study by Glenmede Trust Co., since 1985 stocks with the highest yields have posted an annual return of 15.1%, compared with 10.8% for those with the lowest. Besides, with President George W. Bush setting the agenda for the next four years, the favorable tax treatment of dividends will continue. Henry McVey, U.S. equities strategist at Morgan Stanley, says

FAVORABLE TAX TREATMENT OF DIVIDENDS IS LIKELY TO BECOME PERMANENT

the bank thinks that “capital-gains and dividend relief are likely to become permanent features of the tax code.”

More companies will be paying dividends and staging stock buybacks as they build up record levels of cash on their balance sheets (page 122). Witness General Electric Co.'s Dec. 10 announcement that it will buy back \$15 billion worth of stock and raise its dividend by 10%. GE's stock rose 2% that day alone.

With returns likely to be lackluster on Wall Street, it may be wise to travel abroad for quality. Our Fearless Forecasters are already packing. Their consensus

asset allocation for international stocks jumps to 18% from 14% last year. The weak dollar—down 18% on a trade-weighted basis over the past three years—will continue to be a boon to many foreign companies, especially in countries like China where the currency tracks the dollar.

Emerging markets may be a good play. Raymond A. Mills, manager of T. Rowe Price Group Inc.'s International Growth & Income Fund looks for countries that benefit from growth in China and India. He

likes Australia, Hong Kong, Singapore, and South Korea. Brazil and Russia are also heating up. To get a piece of the action consider emerging-market and country-specific mutual funds or exchange-traded funds (page 103).

Beyond that, selected niche plays could be good bets. For instance, Internet advertising is getting bigger by the nanosecond (page 98). Some alternative-energy companies are also poised to radiate (page 106). And betting on bank

mergers could put a jingle in your piggy bank (page 102).

But for core holdings, look to quality stocks. According to a November study by the National Association of Investment Clubs, 40% of investors think it's a good time to move into less risky investments. That's up from 34% percent in January, 2004. At *BusinessWeek*, we've been talking about investing in quality stocks for the past year. Are investors listening? We certainly hope so. ■

FORECASTERS

Kim Goodwin: How Last Year's Ace Sees 2005

It was a pretty good year for our market strategists, but C. Kim Goodwin was the best. The chief investment officer for equities at Boston's State Street Research & Management Co. figured that, with corporate profits rising and the economic recovery taking root, 2004 stock market gains would be moderate. But she didn't expect that the big rally would come only after the Presidential election. "We had four quarters in a row of more than 20% corporate profit [growth], so I was surprised the markets weren't moving," she says.

The markets sure did catch up with her. Goodwin topped 65 other strategists in *BusinessWeek*'s 2004 market forecast, all but nailing the Dow Jones industrial average, the Standard and Poor's 500-stock index, and the NASDAQ Composite. When we called the winner on Dec. 3, she was 1% over the Dow, 0.75% over the S&P, and less than 0.1% off the NASDAQ. She beat a prescient bunch: 35 others came within 5% overall.

Goodwin, 45, doesn't latch on to companies with a nice story to tell, favoring metrics such as inventory levels and per-customer revenue to arrive at unemotional investment decisions. That philosophy helped as she cut her teeth as a technology analyst with Mellon Bank after masters degrees in business and public affairs at the University of Texas at Austin. It also helped that she "likes roller coasters," she says.

Indeed, it has been a something of a winding road for the Omaha native, whose first exposure to the financial world came by watching Louis Rukeyser's TV show as a kid. She went to Princeton University in the '70s

thinking she might become an architect. It was there she first learned about investing, after getting involved in a student group urging the university to divest businesses with ties to South Africa's then-apartheid regime from its portfolio. "I really learned to do investment research as an undergrad

looking through annual reports," Goodwin says. Must have worked: She ended up a regular guest on Rukeyser's show.

Goodwin's crystal ball shows a more subdued year ahead, as inflationary pressures, exacerbated by a weak dollar, could hinder growth. "I think that [the yearend rally] will extend through the first quarter of 2005," she says. "But then I'm a little concerned that as interest rates pick up, you can see that recovery sputter a bit." She calls for a Dow finish of 10,900, 1,250 for the S&P, and 2,210 for the NASDAQ. That's near the low end of the market forecasters we polled this year (page 78). But she's simply going where the numbers tell her to.

—By Brian Hindo in New York



The Winning Prediction for 2004

	DOW JONES INDUSTRIAL AVERAGE	STANDARD & POOR'S 500- STOCK INDEX	NASDAQ COMPOSITE	RUSSELL 2000 INDEX**
GOODWIN'S FORECAST	10,700	1,200	2,150	600
ACTUAL LEVELS*	10,592	1,191	2,148	642

*Dec. 3 **Not considered for forecast

Data: BusinessWeek, Yahoo! Finance

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What the Fearless Forecasters See

DATA COMPILED BY BRIAN HINDO, ANNE TERGESEN, AND SUZANNE WOOLLEY

The BusinessWeek Market Survey

NAME / FIRM	DOW JONES INDUS. AVG.		NASDAQ COMPOSITE		RUSSELL 2000		ASSET ALLOCATION*			FAVORITE STOCK SECTOR	FAVORITE STOCK	
	MIDYEAR	YEAREND	S&P 500 YEAREND	YEAREND	YEAREND	YEAREND	U.S. STOCKS	INTL. STOCKS	U.S. BONDS			CASH
PETER TRAPP Bifrost Partners	11750	12750	1500	2000	800	800	40	40	0	10	Technology	Scor
ARVIND SACHDEVA Victory Capital Mgmt.	10850	12500	1425	2600	790	790	62	0	34	4	Ind. Cyclicals	Newmont Mining
ELAINE GARZARELLI Garzarelli Capital		12400	1420				100	0	0	0	Ind. Cyclicals	Merrill Lynch
SAM STOVALL Standard & Poor's	11795	12235	1300	2360			45	15	25	15	Financials	RPM Int'l
MARK ELENOWITZ TriPoint Capital Advisors	11500	12000	1350	2400	710	710	65	20	10	5	Health Care	AXM Pharma
LARRY SMITH Third Wave Global Investors	11250	12000	1350	2500	725	725	50	25	15	0	Technology	
JOHN J. REGAN Americal Investment Strategies	11009	11901	1383	2760	767	767	70	10	0	5	Technology	Dell
GEORGE JACOBSEN Trevor Stewart Burton & Jacobsen	11350	11800	1275	2400	700	700	80	0	10	10	Ind. Cyclicals	DeVry
LIZ ANN SONDERS Charles Schwab	12500	11800	1320	2275	680	680	50	20	25	5	Energy	Cal Dive International
JOHN CLARKE H.C. Wainwright	11235	11796	1311	2388	705	705	40	25	15	10	Technology	Multiband
YOUNG CHIN Gartmore Global Investments	11194	11754	1246	2191	665	665	30	40	5	0	Energy	Starwood Hotels & Resorts
EDWARD YARDENI Oak Associates	11000	11700	1300	2400	750	750	65	15	10	5	Technology	eBay
TOBIAS LEVKOVICH Citigroup Smith Barney		11700	1225				60	0	35	5	Health Care	Carnival
GARY TAPP SunTrust Robinson Humphrey	11010	11680	1273	2280	688	688	65	20	10	0	Ind. Cyclicals	Aetna
ARTHUR HOGAN Jefferies	11235	11663	1297	2353	690	690	60	10	20	10	Technology	Lions Gate Entertainment
JAMES WONG Payden & Rygel Investment Mgmt.	11100	11600	1340	2500	720	720	30	20	20	10	Energy	Ryland Group
TIMOTHY J. LEACH US Trust	11000	11600	1285	2250	680	680	44	11	20	0	Energy	
STUART FREEMAN A.G. Edwards & Sons	11400	11600	1300		682	682	65	10	20	5	Cons. Staples	Citigroup
JOSEPH BATTIPAGLIA Ryan Beck	11100	11600	1300		660	660	72	8	5	0	Ind. Cyclicals	Books-A-Million
ROBERT MORRIS Lord, Abbott	11000	11550	1301	2301	695	695	75	15	10	0	Ind. Cyclicals	Telekom Austria
ALLAN RONESS ASR Corporate Consultants	11150	11505	1255	2450	700	700	60	15	0	15	Technology	Encore Acquisition
RICHARD DICKSON Lowry's Reports	11500	11500	1300	2100	605	605	70	30	0	0	Ind. Cyclicals	Wyeth
HUGH JOHNSON First Albany Capital	10940	11500	1300	2300	680	680	100	0	0	0	Cons. Staples	Walt Disney
JEFFREY KLEINTOP PNC Advisors	11100	11500	1300	2320	685	685	57	13	25	5	Ind. Cyclicals	Wellpoint Health Networks
JAMES PAULSEN Wells Capital Mgmt.	12300	11500	1325	2350	690	690	40	30	20	0	Technology	
CARL DUMACK Investment Management	11950	11500	1290	2280			70	0	30	20	Technology	
ROGER O'BARO iGlobal Capital	11600	11490	1224	2223	663	663	40	5	15	35	Financials	Merrill Lynch

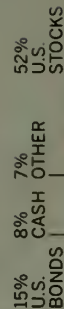
Get used to single-digit returns, say the 67 stock market

strategists we polled for their 2005 market outlook. They anticipate a gain of 6.8% for the Dow Jones industrial average in 2005 and 7% for the Standard & Poor's 500-stock index. Investing abroad gained favor, with the consensus asset allocation for international stocks jumping to 18%, up from 14% last year. Strategists are listed according to their year-end Dow forecasts, from the most bullish

to the most bearish

	HIGH	LOW	AVG
Dow Jones Industrial Average	12750	8000	11263
S&P 500	1510	825	1271
Nasdaq Composite	2760	1600	2264
Russell 2000	800	450	673

CONSENSUS ASSET ALLOCATIONS



MOST POPULAR SECTORS

	NUMBER OF RECOMMENDATIONS
Energy	16
Technology	14
Industrial Cyclicals	14
Health Care	7

MOST POPULAR STOCKS

	NUMBER OF RECOMMENDATIONS
Citigroup	2
Intel	2
Merrill Lynch	2
Pfizer	2

ROGER DEBARD (Global Capital)	11600	11490	1224	2223	663	40	5	15	35	Financials	Merrill Lynch
CHARLES MAYER Pioneer Investments	10725	11470	1270	2205	707	65	10	20	5	Ind. Cyclicals	
IVAN GEFEN vFinance	11000	11450	1285	2300	680	35	20	20	15	Services	
CHARLIE CRANE Scotsman Capital Mgmt.	11200	11450	1280	2250	650	90	0	0	10	Cons. Staples	Chubb
HARVEY HIRSCHHORN Bank of Amer. Invest. Strat. Grp.	11000	11350	1300	2350	700	53	11	29	3	Ind. Cyclicals	
RICHARD SICHEL The Philadelphia Trust Co.	11019	11350	1264	2311		65	0	35	0	Financials	Alliant Techsystems
CLARE ZEMPEL Zempel Strategic	10925	11350	1300	2275	700	50	20	20	10	Health Care	Pfizer
JASON TRENNERT ISI Group	11000	11300	1350	2450	710	65	10	10	15	Technology	Charles Schwab
JOHN LEO Northern Trust Investments	11025	11250	1260	2175	660	60	20	13	7	Ind. Cyclicals	Caterpillar
CHRISTOPHER CONKEY Evergreen Investment Mgmt.	11000	11250	1275	2250	675	50	25	20	5	Ind. Cyclicals	Asta Funding
RICHARD DRIEHAUS Driehaus Capital Mgmt.	10900	11250	1280	2200	700	50	30	0	10	Energy	Digital Angel
BARRY HYMAN Ehrenkrantz King Nussbaum	11000	11200	1270	2300	680	70	0	15	15	Ind. Cyclicals	Biogen IDEC
ROD SMYTH Wachovia Securities	11000	11200	1270		680	40	25	25	10	Energy	
MARK JORDAHL U.S. Bancorp Asset Mgmt.	10800	11175	1260	2250	660	48	18	28	0	Technology	Intel
JACK ABLIN Harris Private Bank	11384	11172	1256	2255	675	40	50	0	0	Health Care	
ARNIM HOLZER Deutsche Asset Mgmt.	10800	11145	1275	2200	660	55	15	20	0	Energy	
ALISON DEANS Lehman Brothers		11100	1300		711	26	25	18	0	Energy	
ASHER PLAUT Brill Securities	10950	11100	1510	2410	675	70	15	10	5	Health Care	Natus Medical
VINCENT SBARRA HPC Capital Mgmt.	10850	11050	1252	2232	590	40	5	5	15	Technology	Perma-Fix Environment. Svcs.
LAWRENCE G. McMILLAN McMillan Analysis	13200	11040	1250	2180	655	60	20	10	10	Energy	Cameco
DORSEY FARR Wilmington Trust	11035	11035	1240	2190	655	26	18	20	0		
SUBODH KUMAR CIBC World Markets	11500	11000	1250	2500	650	36	31	17	5	Technology	Cisco
TOM MCMAHUS Banc of America Securities	10700	11000	1200	2200	600	55	0	10	25	Energy	Apache
JIM HUGUET Great Companies	10750	10955	1245	2450	704	45	35	20	0	Financials	American International Group
WENDELL PERKINS Johnson Asset Mgmt.	10700	10950	1225	2170	639	30	40	10	10	Health Care	Multimedia Games
WARREN BAGATELLE Loeb Partners	10750	10950	1350	2300	650	65	0	10	7	Health Care	Pfizer
WILLIAM GREINER UMB Investment Advisors	10800	10900	1265	2250	655	50	15	30	5	Ind. Cyclicals	Cintas
C. KIM GOODWIN State Street Research	10500	10900	1250	2210	625	40	25	30	5	Cons. Staples	Equity Office Properties Trust
SEAN TAYLOR GAM	10100	10750	1250	2300	640	25	75	0	0	Services	WebZen
JEFFREY KNIGHT Putnam Investments	11200	10640	1160	2055	642	30	25	15	0	Energy	
ROBERT H. STOVALL Wood Asset Management	10965	10625	1365	2175	628	40	20	15	10	Energy	Tiffany
DANIEL DEKTAR Smith Breeden Associates	10500	10600	1195	2000	645	15	25	15	15		
DAVID M. JOY American Express Financial Advisors	10500	10150	1150	2035	610	30	40	20	10	Energy	
JOE LIRO Stone & McCarthy Research Assoc.	9650	10100	1150	2250	720	40	25	20	15	Technology	Intel
BARRY RITHOLTZ Maxim Group	11707	9703	950	1825	606	50	25	15	5	Financials	InterOil
MICHAEL PAINCHAUD Market Profile Theorems	9200	8800	990	1620	450	30	10	10	30	Utilities	IMAX
BERNIE SCHAEFFER Schaeffer's Investment Research	9000	8000	825	1600	550	30	15	15	20	Energy	XM Satellite Radio Holdings
ML GLOBAL STRATEGY & ECONOMICS Merrill Lynch			1205		45	0	45	10	Utilities		
CONSENSUS	11054	11263	1271	2264	673	52	18	15	8		

* Asset allocations do not total to 100 in some cases because of allocations in other categories such as gold, REITs, hedge funds, derivatives, and non-U.S. bonds



Picks of the Pros, Plus How to Avoid Sand Traps

The mavens we've assembled the past two years have done quite nicely, thank you. Can this bunch measure up? **BY DAVID HENRY**

FOR A VIVID VIEW OF Wall Street's best investment ideas, gather a few industry veterans in a room to hash out their top stock picks. We did just that a year ago. Our list of 20 stocks delivered a 23.8% total return, nearly double the 12.5% from the Standard & Poor's 500-stock index, according to FactSet Research Systems. The year before, our panel beat the market by nearly eight percentage points. So, aiming for a hat trick, we assembled another group early in December when the S&P was at 1,191. Richard Bernstein, the chief U.S. strategist at Merrill Lynch & Co., a notorious worrywart, recommended stocks that could shelter investors from rising short-

term interest rates and slowing earnings growth. Mary Farrell, chief investment strategist at UBS Securities and a 33-year-veteran of the market, went for multinational companies that will benefit from the weaker dollar. Robert W. Smith, portfolio manager of the T. Rowe Price Growth Stock Fund, which has a 5-star rating by Morningstar.com, sought out cheap, steady-growth stocks. Repeat panelist David J. Williams, portfolio manager of the Excelsior Value and Restructuring Fund at U.S. Trust Corp. whose picks returned 43% this year, was the most up-beat of all. He told of enticing stocks from Brazil that trade in New York. Here are the highlights:

In 2005, are stocks going up or down?

FARRELL I'm moderately bullish. The S&P should gain 6% or so, to about 1,265. The market is starting out neither cheap nor expensive, so it should track earnings.

BERNSTEIN Stocks are going up little. My target is 1,205, up about 1%. Plus you'll get a couple of percent from dividends. It could be a rough ride even for that. The Federal Reserve is going to be tightening short-term interest rates at the same time profit growth is slowing down to about half the 18% we've been getting in 2004. That's a coincidence that never ended well under [Fed Chairman Alan] Greenspan. It contributed to the early-1990s recession, the 1998 financial crises, the deflation of the tech bubble, and the last recession.

SMITH The year will be better than that. I

Richard Bernstein

COMPANY/ SYMBOL	PRICE*	P-E RATIO**
ABBOT LABS ABT	43.74	17
AFFILIATED COMP. SERVICES ACS	58.98	19
AMEREN AEE	48.57	16
BANK OF AMERICA BAC	45.88	11
EXXON MOBIL XOM	50.15	15

Note: Panelists, or their firms, have financial interests in many of these stocks

* price as of Dec. 10 for all tables

** Based on forecast earnings for fiscal 2005 for all tables

Data: Bloomberg Financial Markets, V/B/E/S

see the S&P going up 10%, maybe even 15%, before falling back in 2006. The international economy will be even stronger. That said, you want to be guarded, because picking stocks won't be easy. This is not the time to take a lot of risk.

WILLIAMS It is not going to be so hard. We're in the midst of a great

market that is going to do fine in 2005, probably up 13% or so, to 1,350 on the S&P. The economy is growing at 3.5% with low inflation and low interest rates. The pro-growth Republicans dominating the government can produce, then stock prices could explode. Besides, Rich, the Fed is not changing rates enough to restrict growth. They're just tightening a little to neutral.

What is the best way to pick stocks now?

BERNSTEIN Look to stocks with the most dependable earnings. Like other high-quality assets, they have done well when the Fed tightened rates while profit growth decelerated. The market will turn to them more than now, when people love lower-quality assets. Small-cap stocks, cyclical companies, and emerging-market stocks will give you a hard time in 2005.

SMITH Rich is right to be careful. You'd be taking too much risk and paying too much for really fast-growing companies, like eBay, Yahoo!, and Starbucks, whose stocks have soared the past two years. We own some of those, but it is scary because they are very, very expensive. You're better off with companies consistently growing 10%, which is still about 8% faster than the market. Wal-Mart Stores and Citigroup are lower-growth, big companies whose stocks haven't moved even though they've doubled their earnings the past five years.

WILLIAMS I am taking more chances. I've

been buying Interpublic as a turnaround play. They manage advertising, which is a big deal in this global economy. The company has had problems, so the stock is around \$12, down from \$60 a few years ago.

How should investors play the dollar?

FARRELL It is key to stock selection. The dollar is going to continue to fall, probably to \$1.40 against the euro by yearend 2005. The U.S. current account deficit is so big that something has got to give. I like U.S. companies that get 40% of their earnings from outside this country. PepsiCo will get a nice kick from earnings overseas.

SMITH The dollar's downtrend is one reason I like Citigroup. It is one of the best international financial companies. Switzerland-based UBS, which trades here, is another favorite. If assets move out of the U.S. because of the weak dollar, UBS's private banking business will be one place they go. Deere will have a pricing advantage with its farm equipment over its Euro-based competitors.

WILLIAMS I think the dollar is going to be fine; kind of status quo, would be my guess. The stock market has been indifferent to the dollar, unlike the media, which seem to be carrying the ball here.

So Dave, what's up with you and foreign stocks? You like two from Brazil.

WILLIAMS They're real companies with real products, and the stocks still trade at low valuations. Embraer's new airplane is getting rave reviews. Petrobrás is a safe, established international oil company that

pays a better dividend [2.9%] than ExxonMobil. It sells for just five times earnings. Emerging markets have lower tax rates, and they want free trade.

SMITH Embraer is very interesting. Emerging-markets companies are getting better, and you're going to see that continue.

FARRELL I'm still inclined to play a lot of these countries by buying U.S. companies that sell overseas. It is less risky.

Could oil prices spoil it all?

FARRELL Oil is a wild card. It is hostage to a

"THE U.S. DEFICIT IS SO BIG THAT SOMETHING HAS GOT TO GIVE"

lot of forces beyond normal supply and demand. But at UBS we're forecasting prices will go down.

SMITH Lower oil prices will help Wal-Mart. Their average customer makes \$30,000 a year and has been hurt by high gasoline prices. Those customers have really, really been in a recession for about five years, yet Wal-Mart has been growing earnings 14% annually.

BERNSTEIN Energy prices will cycle up and down, but the secular trend is higher. We've been bulls on energy stocks for three years, but the shares have gotten more speculative, and we've backed away from refiners and drillers. It is better to hide out with big, reliable guys like ExxonMobil.

WILLIAMS You can still make some money in oils. Everyone hates Calpine Corp., but I own it. The company is making progress with a big financial restructuring. If they just liquidated the company, you'd get \$6 a share, and the stock's selling at \$3.50.

BERNSTEIN Some energy stocks pay



Mary Farrell

COMPANY/ SYMBOL	PRICE	P-E RATIO
LEGGETT & PLATT LEG	29.79	18
PEPSICO PEP	51.22	20
PFIZER PFE	27.09	12
STANLEY WORKS SWK	47.11	15
WELLS FARGO WFC	63.02	14

The Big Picture Gurus

good dividends, which are critical when stock returns are generally low. Since mid-1998, in fact, dividends have made up virtually all of the 2% annual return from the S&P 500. Ameren, a Midwest utility, yields 5.2%.

WILLIAMS Utility stocks have done really well already this year.

BERNSTEIN Yes, but mutual funds haven't bought enough of the stocks. You can still get them without overpaying.

FARRELL Dividends are getting better tax treatment now. And they're growing faster, up from a rate of about 3.8% in the early 1990s to 12% in 2004. We're looking for 18% growth in 2005. Leggett & Platt, Stanley Works, and Wells Fargo have all grown their dividends about 5% a year the past decade.

BERNSTEIN A prime reason to own Bank of America is its 3.9% dividend.

SMITH I'm less interested in dividends than in whether companies are generating the free cash flow to pay them, to buy back stock, or to buy good companies. Citigroup and UBS pay good dividends. But I really like that Citi is growing its free cash 10% a year and making good acquisitions.

Aren't financial companies going to get hurt by rising short-term interest rates?

SMITH They are widely disliked on Wall Street. But I look at the growth potential and their attractive stock prices. Their p-e multiples have gone down. Citigroup will continue to rack up double-digit earnings growth the next three years even as rates go up.

WILLIAMS Citigroup doesn't get credit for a lot of good stuff they're doing. They're

Robert W. Smith

COMPANY/ SYMBOL	PRICE	P-E RATIO
CITIGROUP C	45.91	11
CORNING GLW	11.23	19
DEERE DE	70.56	12
UBS UBS	81.22	12
WAL-MART WMT	52.71	22

big in emerging markets, and the stock sells at 11 times earnings. Financials are a good contrarian bet for next year. For good dividends, good growth, and cheap multiples, buy some financials. Morgan Stanley is probably the best investment bank, and the stock sells at just 12 times earnings.

BERNSTEIN The risk in the financial sector is in subprime lending. That's not Bank of America, which we like. It is well diversified.

FARRELL We think Wells Fargo has good risk management and growth. It hasn't really leveraged its balance sheet.

WILLIAMS Don't forget Wells Fargo's exposure to mortgages and housing.

The market's down on pharmaceutical stocks, too. Is it wrong?

FARRELL This is a good chance to buy Pfizer. The stock has been weak. They have quite a pipeline of drugs, and that should go a long way toward offsetting patent expirations. I'm looking for a nice return from solid 10% earnings growth and a 2.5% yield.

BERNSTEIN People are going to start reevaluating the drug companies. They're going to sort out their litigation risk and future cash flows and buy some of them again.

SMITH Maybe, but I can't think of any companies where you know so clearly that a big part of their

David J. Williams

COMPANY/ SYMBOL	PRICE	P-E RATIO
CALPINE CPN	3.59	N.A.
EMBRAER ERJ	29.46	12
INTERPUBLIC IPG	12.84	21
MORGAN STANLEY MWD	53.70	12
PETROBRAS PBR	36.04	5



income is going to disappear. Take Bristol-Myers Squibb. Unless it does something dramatic, it is unlikely to have earnings growth for three years.

BERNSTEIN The most attractive area health care is selling hospital supplies. Abbott Laboratories does it. Its shares have been left behind despite new products.

Does anyone recommend tech stocks?

SMITH I like Corning. They're one of a few makers of good glass for flat-screen TVs. As prices come down, their business will grow 30%-plus for three years and drive earnings. They made a huge mistake with fiber optic in the past. But the business is O.K. now and could make Corning a great stock if phone companies buy a lot more fiber to compete against cable.

BERNSTEIN I bought one very chicken tech stock, Affiliated Computer Services. It does info-tech services, where the revenues are steadier. The stock is countercyclical and cheaper than the rest of tech.

SMITH The basic problem with tech is that there are no products offering great growth. Cell phones have pretty much played out. There's no great new software application. Internet advertising is wonderful, but the stocks are expensive. We played Yahoo and Google. We like eBay. But it is the wrong time to recommend buying them.

BERNSTEIN The problem investing in tech is that you have overcapacity now, more coming online, and companies burning cash. That's the opposite of energy. Portfolio managers should have only about 10% in tech, about half as much as the S&P.

Thank you all. ■





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Five Wild Cards For 2005

What could throw the economy for a loop? Here are some threats worth watching

BY JAMES C. COOPER & KATHLEEN MADIGAN

THERE'S AN OLD SAYING in economic forecasting: The consensus is always wrong. That's why the key to investing wisely in 2005 may well lie in considering how the economy will stray from expectations. To evaluate the risks and possibilities for 2005, *BusinessWeek* asked the economists in our annual outlook survey to think outside the box of their basic forecasts by identifying the wild cards that could have a positive or negative impact on the outlook. That's not to say consensus forecasts are useless. Far from it. They provide an important baseline for judging the economy's performance as it plays out. For 2005, the 60 forecasters we surveyed expect, on average, that the economy will grow 3.5% from the end of 2004 to the end of 2005 (table, page 92). That's a bit below the 3.8% pace expected for 2004. The consensus view is that profit growth will slow to 6.7%, and inflation will fall, as oil prices slip to \$39 per barrel by the end of 2005. The Federal Reserve will keep lifting the federal funds rate, to nearly 3.5% by yearend, from 2.25% now, and

the yield on 10-year Treasury bonds will increase from 4.3% to 5.1%. In general, economists see the dollar slipping at a gradual pace of about 10% against major currencies and 5% vs. all currencies. The jobless rate should fall from 5.4% to 5%.

All in all, that's not too shabby. But what could throw the consensus for a loop? Here are five economic wild cards for 2005 that bear close scrutiny as the year progresses. They're especially important because they are interrelated: A surprise in one area could generate unexpected consequences elsewhere. These wild cards are the most credible threats to the general forecast—and to the value of your portfolio.



WATCH OUT FOR FALLING DOLLARS

A POSSIBLE CRASH in the U.S. dollar surpassed even oil prices as the biggest question mark on economists' minds for 2005. "This has been my worst nightmare for some time," says Nicholas S. Perna of Perna Associates in Ridgefield, Conn. The growing concern is America's ability to attract the massive amount of foreign capital it requires to finance both private and public investment. The trouble: A rising federal budget deficit subtracts from the available pool of domestic savings, even as the widening trade deficit adds to the financing needs.



*Argentina, Brazil, Chile, Colombia, Mexico, Venezuela, China, Hong Kong, India, Indonesia, Korea, Malaysia, The Philippines, Singapore, Taiwan, Thailand, Israel, Saudi Arabia, Russia

Data: Federal Reserve, BW, Global Vantage Inc.

To help track U.S. competitiveness in global markets, the Federal Reserve calculates a trade-weighted index of the dollar vs. the major currencies, like the euro and yen, and vs. those of emerging nations. For a weekly update, go to: <http://www.federalreserve.gov/releases/h10/Current/>

The danger, says Perna, is a loss of confidence in the U.S. economy and the running its economic policy that could play out in a rerun of the 1980s. Early that decade, the stimulative effects of budget deficits helped to push up the dollar and the trade deficit. But in 1985, the dollar plunged 40% vs. major currencies, yields on Treasury bonds jumped two percentage points, and stock prices plunged 30% in October, 1987.

Economists already see some increasing reluctance by both private investors and central banks to hold U.S. Treasury securities. But if the greenback really tanks, "the primary effect will likely be on the U.S. corporate bond market, where overseas investors—largely Europeans—account for about half of new-issue buying," says Vincent Boberski at RBC D



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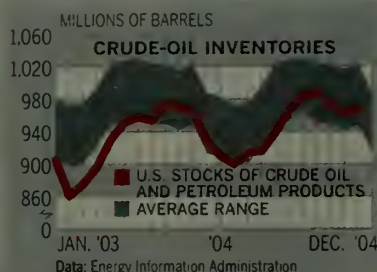
nokia.com/us

Rauscher in Minneapolis. Sharply higher interest rates would be especially damaging to a frothy housing market, the stock market, and heavily indebted consumers. More ominously, higher rates would increase the risk of an outright recession.



AVOIDING ANOTHER OIL SLICK

UNLIKE THE DOLLAR, oil is a wild card that could swing either way. On the negative side, another spike in oil prices could slow consumer demand just as it did in 2004. "If oil remained at \$50 to \$55 per barrel, it would lower gross domestic product growth next year by about one percentage point," says Richard D.



Oil prices have declined recently in part because crude inventories have risen into a more normal range. For a better understanding of the energy markets, check out the Energy Information Administration at www.eia.doe.gov, and click on "This Week in Petroleum."

Rippe at Prudential Equity Group. Other economists worry that, given the right geopolitical upheavals or supply disruptions, oil could hit \$60 or \$70, a shock that would further crimp household buying power and pummel corporate profits. "Oil prices at \$80 would undermine business and consumer confidence sufficiently to cause a mild recession late next year," says Kurt Karl of reinsurance firm Swiss Re.

But economists see an equal, if not greater, chance that oil prices could fall, perhaps to \$25 per barrel. That could be precipitated by several factors, including an expected slowdown in global demand, a mild winter, or an easing of Mideast tensions either in Iraq or between Israel and the Palestinians. Cheaper oil "would spark a period of very strong growth in the U.S. as consumers and companies respond to the cash flow gains generated by the drop, pushing growth towards perhaps 6% for a time," says Ian C. Shepherdson of High Frequency Economics in

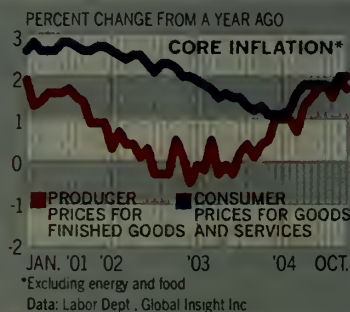
Valhalla, N.Y. Stock prices would benefit handsomely, and the wealth effect would support consumer spending. However, don't expect falling oil prices to keep rates down. "The Federal Reserve would probably continue to raise interest rates with the economy growing above its potential," says Lynn Reaser at Banc of America Capital Management in St. Louis.



INFLATION BREATHES FIRE

OIL AND THE DOLLAR have one thing in common: the potential to affect inflation. That may well explain why our survey's inflation forecasts vary more than usual, from 1.2% to 4.4%. Consumers and businesses could easily adjust to a return of low inflation after 2004's oil-fueled rise. But if prices pop up 4%, that would send both bond investors and the Fed scrambling. "We believe there is a significant risk that inflation will be higher than expected," says Lynn O. Michaelis at Weyerhaeuser Co., noting that the dollar's drop and higher commodity prices are just beginning to wend their way into final goods prices. Matters could be worse if China revalues its currency higher. "This would result in revaluations of other Asian currencies and allow U.S. businesses to become more aggressive in their pricing," says Mark Zandi at Economy.com Inc.

Bear in mind that many of the factors that held inflation down during the 1990s are reversing. And it's not just the weaker dollar or costlier energy. First, productivity growth is slowing, as it does when a recovery matures. That, together with a tightening job market, will push up unit labor costs. Second, factories are busier.



To look at inflation in the same way the Fed does, you have to strip out energy and food. The Labor Dept. calculates these core inflation rates in their reports on consumer and producer prices. Find them at www.bls.gov/home.htm

"The Fed's capacity numbers understate the true capacity utilization rates," assert Robert Shrouds at DuPont. "Based on the experience at my company, utilization rates are high across a broad range of products." Lastly, monetary policy is still unusually accommodative, with the Fed's target interest rate still close to zero after adjusting for inflation. An inflation surprise would cause the Fed to lift rates more and faster than expected.



POP GOES THE HOUSING BUBBLE

IF RATES RISE FASTER than the consensus expects, housing is especially vulnerable, say some economists. "Houses that look affordable now would not look so with mortgage rates two percentage points higher," says Narima Behravesh at Global Insight Inc. i



The Office of Federal Housing Enterprise Oversight's index of home prices keeps track of the same sample of houses being sold over time. The quarterly report also gives a regional breakdown of price trends. To find out about home values in your area, go to: www.ofheo.gov/HPI.asp

Waltham, Mass. If mortgages rise to 8% many buyers would have to scale back their aspirations, and some homebuyers would be priced out of the markets, causing a downshift in home demand.

More important, a weaker housing market would prick any bubble in price, deflating household wealth. Consumers would have to save more and shop less. And with mortgage rates up, refinancing would dry up, also crimping spending.



AS THE WORLD CHURNS

ANOTHER WILD CARD foremost in our economists' minds is a sharp slowdown in global growth. "The euro area is weighed down by currency appreciation and the absence of any domestic demand dynamic," says Bruce Kasman

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JPMorgan Chase & Co., "and Japan's recovery could prove disappointing." If China's efforts to cool off its economy rip its fragile financial fabric, that could have global repercussions. The risk is that weak demand would cut into U.S. exports, thwarting the chances for a lower dollar to help stabilize the trade deficit.

Not surprisingly, the threat of terrorism looms over all. "A terrorist strike in the U.S. or marked escalation of the conflict in the Middle East could result in an attendant drop in business confidence that would undermine the expected recovery in invest-

COUNTRY	REAL GDP	
	2004	2005
BRITAIN	3.4	2.5
CANADA	2.9	3.1
CHINA	9.0	7.5
EURO ZONE	2.2	2.2
INDIA	6.4	6.7
JAPAN	4.4	2.3
MEXICO	4.0	3.2

Data: IMF

World growth will be slower in 2005 than in 2004. You can get an outlook on just about any nation from the International Monetary Fund at www.imf.org

ment and employment," says Ti O'Neill at BM Financial Group/Harris Bank in Toronto. Another attack could hasten the dollar's decline, roil the financial markets, and harm the economy.

The problem is that terrorist attacks are impossible to forecast. But that on illustrates how one day's events can derail a yearlong consensus forecast. If it goes according to the forecasters' plan, 2005 should be a decent year for both the economy and a well-balanced portfolio. But investors should heed the lesson of recent years: Expect the unexpected.

WINNERS

Stuart Hoffman: Now, That Was a Close Call

A year ago, when Stuart G. Hoffman opened his copy of *BusinessWeek* to the 2004 economic survey, he was surprised to find his forecast for growth of 3.8% below the average projection of 4.1%. But the chief economist of PNC Financial Services Group Inc. in Pittsburgh didn't second-guess his expectations. As he saw it, the economy would slow down in the coming year, in part the result of less government stimulus. Hoffman was smart to trust his instincts: His was the most accurate forecast of 2004.



Nicholas Perna of Perna Associates LLC in Ridgefield, Conn., came in second.

Hoffman figured higher interest rates and a lack of new tax cuts would slow demand. Plus, he correctly expected some domestic spending would be satisfied by imports, widening the trade deficit and slowing U.S. growth. He also expected the troubles in Iraq and concerns over supply to lift oil prices, though not over \$50 a barrel. "I thought \$40 would be pretty high," he says. "I never thought it would go as high as it did."

Hoffman, 55, began his career at the Federal Reserve Bank of Atlanta after he earned his master's and doctorate degrees in economics at the University of Cincinnati. After six years down south, he returned to his native Pittsburgh to join the economics team of the old Pittsburgh National Bank, which later grew through mergers and acquisitions into PNC Financial.

In September, 2004, Hoffman was sworn in as vice-president of the National Association for Business Economics after five years on its board. It was his long

association with NABE that put Hoffman at the group's annual conference in the Marriott World Trade Center next to the Twin Towers on September 11, 2001. It took four hours before he was reunited with his wife, Jody, a retired teacher, who was in their 19th floor hotel room when the first plane hit. "You don't forget it when you're right in the middle of history," says the longtime reader of Presidential biographies.

For 2005, Hoffman's 3.3% growth forecast is once again a shade below the consensus call of 3.5%. He thinks job growth and lower oil prices will aid consumer spending. But smaller gains in house prices and higher rates will limit home equity loans and refinancings: "Consumers can't use their homes as ATMs anymore."

Luckily, business will take up some slack. "Solid internal cash flows and ample external financings from banks and capital markets [will] help lift capital spending by 6% to 8% next year," he says. With the Fed likely to hike rates all through 2005, he pegs inflation at a tame 2.3%.

Hoffman feels confident about his forecast, but he's even more upbeat about the success of his beloved Pittsburgh Steelers: "We're all very excited here [in Pittsburgh] after years of disappointment." Although it's uncertain how far the Steelers will go this season, Hoffman has found a game plan for winning: Trust your gut, and don't worry what others think.

—By Kathleen Madigan in New York

The Winning Forecast for 2004

	REAL GDP (% CHANGE, ANNUAL RATE)				CPI 3Q	FED FUNDS 3Q	10-YR TREASURY 3Q	JOBLESS RATE 3Q
	1Q	2Q	3Q	4Q*				
HOFFMAN'S FORECAST	4.0	3.5	4.0	3.5	2.3	1.40	4.75	5.8
ACTUAL	4.5	3.3	3.9	3.8	2.7	1.43	4.30	5.4

*Not for release until 2005 BusinessWeek survey



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What About the Climate for Business?

BY JAMES MEHRING

For *BusinessWeek's* annual survey, we asked 60 business economists for their views of the future—including some thoughts on trends, such as job growth (page 84), not included here. The survey is organized, top to bottom, by the economists' forecasts for real GDP growth for all of 2005. To help you make sense of the numbers, we've compiled highlights of what the experts expect. Match each set of data in the table with its color-coded counterpart on the right.

forecasts for real GDP growth for all of 2005. To help you make sense of the numbers, we've compiled highlights of what the experts expect. Match each set of data in the table with its color-coded counterpart on the right.

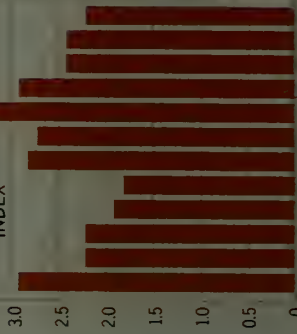
The BusinessWeek Economists Survey

LOOK FOR SLOWER, BUT STILL SOLID, PROFIT GAINS

The consensus view is that growth in operating profits will slow in 2005 after the double-digit gains of 2003 and 2004. But at 6.7%, earnings growth will still be strong enough to support increased capital spending, inventory building, and hiring. And 11 economists, nearly 1 of every 5, are much more optimistic: They see another double-digit rise in profits.

AS OIL PRICES EASE, SO WILL INFLATION

PERCENT CHANGE FROM A YEAR AGO
CONSUMER PRICE INDEX



	QUARTERLY PERCENT CHANGE 2005 ANNUAL RATE				YEARLY PERCENT CHANGE 2004 Q4 TO 2005 Q4		2005 Q4 LEVELS (PERCENT)			END-2005 CRUDE OIL PRICE
	I	II	III	IV	REAL GDP	OPERATING PROFITS*	FEDERAL FUNDS RATE	10-YR. TREASURY YIELDS	JOBLESS RATE	
GAIL FOSLER The Conference Board	5.4	5.1	4.3	3.7	4.6	11.3	4.20	4.70	4.6	41.00
JAMES PAULSEN Wells Capital Management	6.0	5.0	3.0	3.8	4.4	12.0	3.75	5.75	4.7	34.00
ROBERT DICLEMENTE Citigroup Global Markets	3.9	4.4	4.8	4.1	4.3	7.5	3.65	4.90	5.1	42.00
DAVID LEREAH National Association of Realtors	4.2	4.8	4.4	3.8	4.3	9.0	3.30	4.90	5.0	42.00
KATHLEEN CAMILLI Camilli Economics	4.5	4.0	4.2	4.2	4.2	11.0	3.00	4.50	5.0	40.00
MICHAEL ENGLUND Action Economics	4.5	4.3	4.2	3.9	4.2	15.0	3.75	5.40	5.0	41.00
JAMES SMITH Society of Industrial and Office Realtors	3.9	3.1	4.6	4.8	4.2	14.6	2.62	4.47	4.4	21.75
PETER HOOPER Deutsche Bank Securities	4.0	4.1	3.8	3.9	4.0	NA	4.00	5.50	5.2	33.00
JIM MEIL Eaton Corporation	3.9	4.3	3.8	3.9	4.0	2.3	3.45	4.56	5.1	39.00
IAN SHEPHERDSON High Frequency Economics	4.0	4.5	3.5	3.5	4.0	6.0	3.75	5.50	4.7	35.00
RICHARD BERNER / DAVID GREENLAW Morgan Stanley	3.2	3.6	4.3	4.5	3.9	7.4	3.40	5.20	5.3	38.00
RICHARD DEKASER National City	4.0	4.2	3.6	3.9	3.9	4.5	3.69	5.09	5.0	36.45
CHRIS VARVARES Macroeconomic Advisers	3.8	3.8	3.9	4.0	3.9	5.4	3.40	5.30	5.2	41.00
BILL CHENEY John Hancock Financial Services	3.8	4.0	3.7	3.6	3.8	5.0	3.75	5.25	5.2	40.00
NICHOLAS PERNA Perna Associates	3.1	3.5	3.4	3.7	3.8	8.0	3.50	5.44	5.1	40.00
LYNN REASER Banc of America Capital Management	3.8	3.7	3.9	3.7	3.8	9.0	3.41	5.40	5.0	37.00
RICHARD RIPPE Prudential Equity Group	2.7	4.1	4.2	4.4	3.8	2.0	3.30	5.20	5.1	35.00
CONSTANTINE SORAS GurnAllen Financial	3.9	3.5	4.0	3.9	3.8	7.9	3.52	5.14	5.3	38.50

THE FED CAN'T PRESTIGE
It is expected to raise a rate by a half
percentage point in 2005.

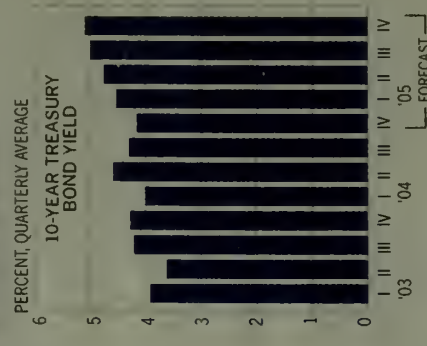
JOHN POPE Investment Economics	3.4	3.5	3.5	3.7	3.7	3.7	7.5	3.0	4.0	4.70	5.5	55.00
NEAL SOSS CSFB	3.7	3.7	3.7	3.7	3.7	3.7	5.8	1.8	3.50	NA	5.1	NA
MICHAEL CAREY Callyon Corporate & Investment Bank	3.5	3.5	3.5	3.9	3.8	3.6	4.0	2.4	3.40	5.30	5.2	38.00
JAMES COOPER / KATHLEEN MADIGAN BusinessWeek	4.0	4.0	4.0	3.5	3.0	3.6	8.0	2.0	3.80	5.50	5.0	35.00
BRUCE KASMAN JPMorgan Chase	3.0	4.0	4.0	4.0	3.5	3.6	7.2	2.1	4.00	5.70	4.9	38.00
KEN MAYLAND ClearView Economics	3.1	3.0	4.0	4.0	4.3	3.6	8.0	2.8	3.92	5.20	4.6	41.50
KEN MCCARTHY vFinance Investments	3.7	3.5	3.3	4.0	3.6	3.6	12.0	2.0	3.45	4.85	5.1	35.00
ROBERT MCGEE US Trust	3.4	3.6	3.8	3.5	3.7	3.6	3.0	2.0	3.25	4.75	4.6	45.00
MICHAEL MORAN Daiwa Securities America	3.3	3.6	3.8	3.7	3.7	3.6	4.0	1.9	3.65	5.35	5.3	36.00
TIM O'NEILL BM Financial Group / Harris Bank	3.7	3.6	3.5	3.6	3.6	3.6	3.8	1.2	2.95	5.20	5.1	35.00
ROBERT SCHNORBUS J.D. Power and Associates	3.9	3.7	3.4	3.4	3.4	3.6	6.6	1.8	3.90	5.20	5.2	34.00
HENRY WILLMORE Barclays Capital	3.0	4.0	4.0	4.0	3.5	3.6	7.0	2.2	4.00	5.30	4.8	47.00
DANIEL LAUFENBERG American Express Financial	3.4	3.1	3.8	3.7	3.7	3.5	5.1	2.5	3.30	5.40	5.1	38.00
LYNN MICHAELIS Weyerhaeuser	3.2	3.7	3.5	3.6	3.6	3.5	11.2	2.8	3.80	4.90	5.3	40.00
DAVID SEIDERS National Association of Home Builders	3.4	3.6	3.5	3.4	3.4	3.5	5.2	2.0	3.40	5.20	5.2	35.00
ETHAN HARRIS Lehman Brothers	3.0	3.3	3.5	3.7	3.4	3.4	6.0	2.4	3.20	4.90	5.2	45.00
GENE HUANG FedEx	3.6	3.3	3.1	3.4	3.4	3.4	8.6	3.0	3.40	5.50	5.2	40.00
MARTIN REGALIA U.S. Chamber of Commerce	3.6	3.6	3.2	3.4	3.4	3.4	NA	1.2	3.50	5.40	5.3	39.00
GARY THAYER A.G. Edwards	3.3	2.9	4.0	3.0	3.0	3.4	9.0	2.6	3.10	5.30	5.2	40.00
STUART HOFFMAN PNC Financial Services Group	3.0	3.2	3.4	3.4	3.4	3.3	7.0	2.3	3.13	5.00	5.1	39.50
KURT KARL Swiss Re	3.0	3.1	3.4	3.3	3.2	3.2	7.5	2.2	3.90	5.00	5.1	50.00
DAVID WYSS Standard & Poor's	3.2	3.3	3.1	3.2	3.2	3.2	3.4	1.6	3.50	5.00	5.2	40.00
RICHARD YAMARONE Argus Research	2.8	4.1	2.5	3.4	3.2	3.2	10.0	3.0	3.00	4.95	5.5	39.88
WAYNE ANGELL Angell Economics	3.0	2.8	3.3	3.6	3.1	3.1	11.0	2.1	2.50	4.00	5.7	38.00
WILLIAM DUDLEY Goldman Sachs	2.5	3.5	3.5	3.0	3.1	3.1	-1.8	2.5	3.40	5.00	5.1	47.75
JOEL NAROFF Naroff Economic Advisors	2.6	3.2	2.9	3.6	3.1	3.1	5.1	2.2	3.90	6.10	4.7	31.00
ALLEN SINAI Decision Economics	3.2	3.5	3.0	2.7	3.1	3.1	1.8	2.5	3.42	5.00	5.0	52.25
MARK ZANDI Economy.com	3.4	2.8	3.0	3.4	3.1	3.1	0.0	1.9	3.40	5.20	5.3	38.00
NARIMAN BEHAVESH Global Insight	2.9	3.3	2.9	2.8	3.0	3.0	0.5	1.5	3.00	4.98	5.4	40.00
MAURY HARRIS UBS	3.2	2.7	3.0	3.0	3.0	3.0	4.6	1.7	3.75	5.40	5.3	34.00
KEITH HEMBRE US Bancorp Asset Management	2.9	3.0	3.1	2.8	3.0	3.0	4.2	1.6	3.00	4.60	5.4	40.00
MICHAEL NIEMIRA Intl. Council of Shopping Centers	3.5	2.5	3.0	3.0	3.0	3.0	6.5	1.8	3.30	5.00	5.3	33.00
STEVEN RICCHIUTO ABN AMRO	3.0	3.3	3.0	2.8	3.0	3.0	2.0	2.8	3.00	4.40	5.3	38.00
JOHN SILVIA Wachovia	2.4	2.8	3.1	3.1	3.0	3.0	10.2	3.2	3.50	5.10	5.3	53.00
VINCENT BOBERSKI RBC Dain Rauscher	3.2	2.8	3.1	2.8	2.9	2.9	NA	1.7	3.50	5.30	5.4	42.00
JEFF WERLING / MARGARET MCCARTHY Inform / Univ. of Md.	3.1	2.9	2.8	2.9	2.9	2.9	7.0	2.8	3.40	5.20	5.3	42.00
ROBERT SHROUDS DuPont	1.5	2.5	3.0	3.0	2.5	2.5	7.0	2.1	3.25	5.00	5.2	38.00
KEVIN LOGAN Dresdner Kleinwort Wasserstein	1.7	1.8	2.5	3.0	2.3	2.3	3.5	1.7	2.25	4.20	5.8	48.00

CONSENSUS

* Before-Tax Corporate Profits with IVA and CCA (NIPA BASIS)

It's expected to raise rates by a little over one percentage point in 2005, but that may not be enough. "The Fed will barely achieve the normal cyclical tightening if it tightens by 25 basis points at every meeting in 2005," says Michael Englund. That implies at least a rise of two percentage points. And any pause by the Fed could mean "much sharper tightening" later in 2005 or 2006, says Englund.

LONG-TERM RATES WILL BE ON THE RISE



The Best Plays

A quick road map to the hottest action and biggest opportunities

THE BUSH FACTOR >> P. 96

How overhauling Social Security and the tax code will affect your portfolio

NET ADVERTISING HITS ITS STRIDE >> P. 98

Under the twin peaks of Yahoo! and Google, a prosperous industry is taking shape

BIG BETS ON BIG SCREENS >> P. 100

Worth monitoring: Manufacturers of chips for flat panels and projection TVs

HUNGRY, HUNGRY BANKERS >> P. 102

Who's likely to be acquired in the year ahead

FOUR COUNTRIES YOU MUST OWN >> P. 103

The newest megatrend is the rise of BRICs: Brazil, Russia, India, and China

ALTERNATIVE ENERGY GETS REAL >> P. 106

Pricy oil and gas are rekindling industry's interest in renewable resources. Plus: A comeback for nukes

GRABBING A GRAN OPORTUNIDAD >> P. 110

Demographics is destiny, and the fast-growing Hispanic population represents a huge opening

COLLECTORS LOVE CHINESE ART >> P. 114

The market is booming, thanks in part to cash-rich investors from the mainland

JACK BLACK



The Bush Factor

What his plans for Social Security and taxes mean for your portfolio. **BY MIKE McNAMEE**

IN THE WEEK BEFORE THE NOV. 2 Presidential election, brokerage and pharmaceutical stocks sank as Democratic challenger John F. Kerry stayed dead even with George W. Bush in pre-election polls. Then, after Bush won, investors piled into those stocks, figuring that the sweeping Republican victory would cut the odds of drug price controls and drive up chances for enacting a Social Security reform that could bring billions in fees to Wall Street.

If only playing the Washington investing game were always so easy. Unfortunately for investors, President Bush's second-term agenda isn't likely to sweep through Congress as quickly as his first-term tax cuts did. And on Bush's biggest initiatives—overhauling Social Security with private accounts and reforming the tax code—the President hasn't filled in the crucial details that will largely determine which sectors win or lose. Investors hoping for policy plays must be patient and attentive as Washington hammers out painstaking compromises. Big uncertainties—from the makeup of Bush's economic team to the President's promise to squeeze spending to the replacement of Federal Reserve Chairman Alan Greenspan in 2006—will cloud the crystal ball for much of the year.

Still, alert investors will find opportunities to capitalize on Bush's initiatives. Here's how:

» SOCIAL SECURITY OVERHAUL

EARLY IN 2005, Bush is expected to unveil his plan to create private investment accounts as part of Social Security. Policy wonks are betting that the White House will model its proposal on one of three

plans studied by Bush's 2001 reform commission. In that version, workers could choose to divert four percentage points of the 12.4% Social Security payroll tax to accounts they would own and could invest in stocks and bonds. Account owners would still collect a basic government-paid benefit, but the monthly check would be cut back over time. Supporters argue that by tapping the higher returns available in the market—5% to 7% after inflation, vs. the 2% that Social Security effectively pays—account owners would have as much or more retirement income than the current system promises.

The prospect of 100 million workers setting up new retirement accounts—and paying fees to brokers or fund managers—fueled the post-election surge in financial stocks. But the Street is a long way from collecting, because Bush isn't guaranteed a win on Social Security. "Reform is still a very big 'if,'" says Chip Dickson, chief U.S. equity strategist for Lehman Brothers Inc. Under any likely plan, the accounts would start out small and be limited to a few investment options, such as diversified index funds. Big mutual-fund managers would be best positioned to capitalize on those—especial-

ly the low-cost players such as Vanguard and T. Rowe Price. Full-service brokers could justify going for what's likely to be low-fee business only if they see the accounts as loss leaders to gain new clients.

The near-certain losers in a Social Security overhaul: bond investors. The transition to private accounts could cost up to \$2 trillion over the next decade. To cover benefits due to be paid from the taxes diverted into accounts, Congress is likely to borrow the funds, and the added debt would push up interest rates and cut the value of existing bonds. "The bond

Capitalizing on Policy Plays

The President's ambitious second-term agenda could have a substantial impact on stocks

SOCIAL SECURITY REFORM

WINNERS Asset managers and mutual funds with low fees and expenses that will be able to meet cost caps on privatized accounts.

LOSERS Bond investors, if Bush chooses to fund the transition by borrowing.

BUDGET

WINNERS If Bush gets serious about controlling spending—and he may—the pressure on bonds might ease slightly.

LOSERS Hospitals and HMOs face tighter limits on Medicaid reimbursement.



TILTING THE TAX CODE TO FAVOR SAVING WILL HELP MANUFACTURERS RAISE CAPITAL

code, the simplest bank account could enjoy better tax breaks than insurers' complicated and expensive variable annuities.

» BUDGET BATTLES

IN HIS FIRST TERM, Bush gave all his attention to tax cuts and none to spending control. He now has the deficits to show for it: a \$348 billion gap projected for fiscal 2005. For his 2006 budget, the President has ordered a strict hold on spending for everything except entitlements and security—and some analysts think he'll actually follow through. "Bush needs to show the bond market and foreign dollar buyers that he's finally getting serious," says Valliere. Among the likely victims: hospitals, nursing homes, and managed-care plans that serve the Medicare health plan for the elderly, all of which will face stricter limits on their reimbursement rates.

» OTHER OPPORTUNITIES

NOVEMBER'S GOP GAINS guarantee hard times ahead for Fannie Mae and Freddie Mac. Coming off accounting scandals at the mortgage giants, Congress is likely to move their regulator to the Treasury with stronger powers. The result could be higher capital requirements and other restraints that will rein in future growth.

Lawsuit reform, a sleeper issue, could drive stocks, too. Capitol Hill negotiators are hoping to agree on a settlement fund to pay damages to workers and others with asbestos claims. The Administration also wants to make it easier for defendants to move class actions to federal courts, where rules are more uniform and judges are thought to be more independent. Homebuilders and manufacturers—especially medical-equipment makers and auto makers—could get a lift. Another big winner would be property and casualty insurers, which would face smaller bills for legal defense costs.

Investors hoping to capitalize on Bush's agenda will need to take a long perspective—and make some bold choices. What promises to be an exciting year in Washington could provide many a thrill for Wall Street as well. ■

market may look at this and say, "This doesn't pass the smell test," says Gregory R. Valliere, managing director of independent policy analysts Stanford Washington Research Group.

» TAX REFORM

BUSH HASN'T GIVEN investors many clues as to how his tax-reform push will affect portfolios. The White House is expected to name a commission to consider tax options by January and recommend a plan to the Treasury by mid-2005. The final result is widely expected to be a sys-

tem that replaces today's patchwork of tax-favored plans for retirement and college and exempts all savings, in whatever form, from income taxes.

A tax code tilted toward saving would favor manufacturers with hefty capital needs—think the Big Three auto makers, General Electric, or pharmaceuticals. The code would tilt against knowledge-intensive service businesses with lighter funding needs. Brokers and money managers could also benefit from increased business, but such life insurers as Lincoln National Corp. could suffer: Under the revised tax

OVERHAUL

WINNERS Manufacturers and other capital-intensive industries that gain from lower financing costs.

LOSERS Service and people-intensive businesses with lower capital needs. Life insurance annuities will lose their tax advantages over other savings products.

OTHER PLAYERS

WINNERS Property and casualty insurers should get a profit boost from lawsuit reform, as legal costs they underwrite come down.

LOSERS Housing's Fannie Mae and Freddie Mac can't escape tougher rules after accounting scandals. Drugmakers also face more regs.



Where the Real Internet Money Is Made

Advertising on the Web could top \$9 billion this year—and there are lots of ways investors can profit from the trend. **BY STEPHEN BAKER**

SOONER OR LATER, ADVERTISERS had to figure out the Internet. Here was a medium that was reaching into nearly every office in America. And at home, it was wresting millions of eyes away from the TV. It could even count mouse clicks. Today, Net advertisers are finally hitting their stride.

It started with advertising on search

engines, such as Google Inc., which collectively grew in five years from near zero to a \$3.9 billion chunk of the online ad industry. Now companies are rushing to promote their brands with ever more banner ads, skyscrapers that crawl up the pages, and full-motion videos. Internet advertising should reach \$9.4 billion in 2004, according to Kagan Research LLC. And with continued double-digit growth, it's on pace to surpass magazine advertis-

ing in about two years, adds Kagan.

Right now, excitement about online advertising is behind a wave of industry consolidation. AOL dished out \$435 million for Advertising.com in June. In mid-November, Dow Jones & Co. agreed to buy CBS Marketwatch for \$515 million, a rich 30 times next year's estimated cash flow. Analysts believe that Dow Jones, whose wsj.com is available to subscribers only, is looking to tap the bounty of ad-

vertising that a free site can attract because it draws more visitors than paid-for competitors. The current fever has a hint of the dot-com craze, but there's one vital difference: While the advertising stars are still spinning bold visions of the online future, they're measuring their progress with profits every step of the way.

SPECIAL AGENCIES

HOW CAN INVESTORS make money on this trend? Lots of ways. Beneath the twin peaks of Yahoo! Inc. and Google—both pricey after sharp runups during the past year—a prosperous industry is taking shape.

In the thick of the surge are ad agencies that specialize in online business. They are pulling advertisers to the Web by providing technology that enables them to measure precisely the impact of any given ad. Or they can follow up with customers who respond to ads. Consider fast-growing aQuantive Inc. The Seattle agency not only helps design campaigns for big-name clients such as Microsoft Corp. and Verizon Communications Co. but is also the leader in managing advertising campaigns on search engines. Using automated technology, it bids on behalf of its customers for millions of search keywords, which are critical to getting ads seen on search sites. That's because each keyword positions a customer's ad next to the results from a specific search, whether the hunt is for can openers or Costa Rica vacations.

This is a booming business for aQuantive, fueling projected triple-digit revenue growth, to \$152 million, with earnings expected to grow from \$11.8 million to \$39 million. Says aQuantive Chief Executive Brian P. McAndrews: "We expect advertisers to keep following the eyeballs [to the Internet]."

Despite aQuantive's success, the stock has been a wallflower. Its \$160 million acquisition of ad agency Razorfish in June took longer to digest than expected. The company fell short of Wall Street's estimates of third-quarter earnings. As a result the stock, at \$8.38, is trading at 30 times projected 2005 earnings—less than

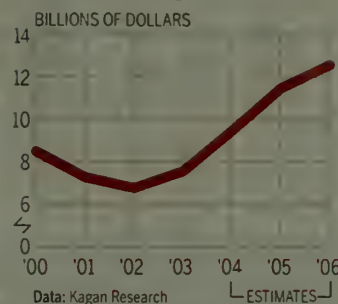
half of Yahoo's price-earnings ratio. Thomas Weisel Partners analyst Christa Sober Quarles says the hiccup offers investors a chance to snap up discounted shares. "As online marketing becomes more complicated, it becomes more important to bring in someone like aQuantive."

ValueClick Inc. is riding the same growth wave. The agency, based in Los Angeles, boasts a broad offering of services, from delivering online ads to monitoring their effectiveness and scoping out the best deals. Unlike aQuantive, ValueClick has not stumbled after doing deals. In fact, it has completed three in the past year without missing a beat. "They have an awesome record of strategic and financial acquisitions," says analyst Stewart Barry of ThinkEquity Partners LLC, a San Francisco investment bank.

The explosion of Internet ad prices—the daily price of a banner ad on marquee sites such as the Yahoo or MSN homepage has doubled in the past year, to \$300,000—is driving yet more advertisers to ValueClick. Its Commission Junction unit places ads on a vast network of Web pages for advertisers. Here, they are charged one-third the price per customer that they would pay on a premier site, according to Barry. Other ValueClick businesses range from search to e-mail marketing. Bolstered by acquisitions, revenue is on track to grow this year by 146%, to \$162 million. Profits are expected to reach \$41 million, with sales growing

Commercializing the Net

U.S. Internet ad sales are on the rise again



31% next year, to \$212 million. The bad news? The stock has doubled since August, and it's now trading at 35 times next year's estimated earnings—pricier than aQuantive.

The Net's ad growth is benefiting online publishers every bit as much as the agencies. The trick, say analysts, is to find sites that reach a well-defined demographic. Here investors might take a

look at iVillage Inc., the top-rated women's site. While men are easy to find at the financial, sports, and tech sites that they troll, women are far harder to locate online. With its attention to everything from child care and dieting to personal finance and astrology, iVillage receives more than 15 million unique visitors a month, nearly all of them women, according to comScore Media Metrix. iVillage leads the industry, with some 14% of U.S. women over 18 years old visiting the site. Says CEO Douglas W. McCormick: "We're a mini Yahoo for women."

IT TAKES IVILLAGE

THE UPWARD TILT on iVillage's stock chart looks every bit as steep as Yahoo's—even though the numbers are far smaller. The stock, a former highflier from the dot-com days, was trading below \$2 in 2003, before McCormick's advertising strategy got going. For 2004 the company figures that revenue will grow by 15%, to \$66.6 million, and that it will eke out a profit of \$3 million, marking its first year in the black in its nine-year history.

The stock now trades around \$5.90, and analyst Youssef H. Squali of Jefferies & Co. sees plenty of room for it to rise. The key, he says, is that iVillage is revamping the site to roll out more video—both for ads and editorial features. "Advertisers are willing to pay 100% more for video than traditional banner ads," he says. And iVillage will create more video programming to accompany the ads, which he says may well attract more visitors to the site. "That could give them two engines of growth," he says.

As Internet ad sales mount, lots of companies are quickly

Netting Online Ad Sellers

COMPANY/ SYMBOL	PRICE*	P-E RATIO**
AQUANTIVE AQNT Boosts powerful clients, from Microsoft to Verizon	\$8.38	30
VALUECLICK VCLK Leader in search and brand marketing	12.92	35
IVILLAGE IVIL Top portal for women will break into the black in 2004	5.90	41
DOUBLECLICK DCLK Takeover prospect as the industry starts to consolidate	7.82	34
INFOSPACE INSP Gets 60% of sales from ads—and has a strong leg in wireless	48.26	27

*Dec. 10 **Based on forecast earnings for 2005
Data: Bloomberg Financial Markets B/E/E

The Best Plays Electronics

steering their businesses toward the bonanza. InfoSpace Inc., the Bellevue (Wash.) company, has made its name selling ringtones for cell phones, but it also has a fast-growing directory business, including Yellow Pages. Ads now account for 60% of revenues. Analysts say the company is well positioned for the widely anticipated growth in local Internet ads.

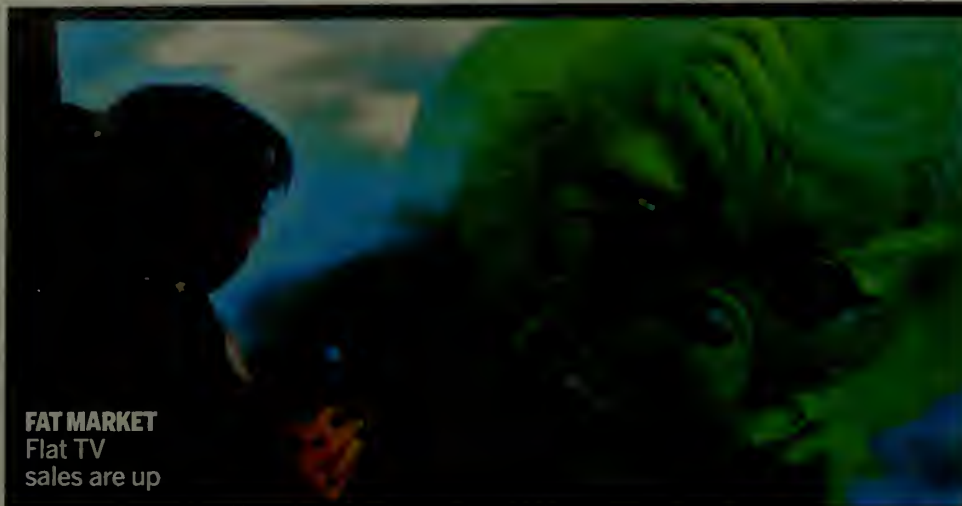
For investors seeking a restructuring play, DoubleClick Inc. merits a look. The onetime titan of Internet advertising, it

stumbled through the tech bust. Revenue dived from \$506 million in 2000 to an estimated \$290 million in 2004. While the company is still in the black, it's losing share to the likes of aQuantive and ValueClick. In November, DoubleClick hired investment bank Lazard LLC to explore its options, including a possible sale of all or part of the company. Since then, DoubleClick CEO Kevin A. Ryan says he has been fielding calls from prospective buyers.

No surprise there. The company still

boasts solid technology to deliver ads on a monitor and fine-tune their performance. These are tools the industry is hungry for. What's more, even after spending \$100 million buying back shares over the past year, DoubleClick is still sitting on \$389 million in cash—40% of its market cap and equal to \$3.10 a share.

Investors can gamble on a possible takeover target or place their bets on a predator. Either way, Internet advertising promises a breathless ride in 2005. ■



FAT MARKET
Flat TV
sales are up

Want to Make Big Bets On Big Screens?

One way is to invest in chipmakers that are supplying the industry. **BY CLIFF EDWARDS**

IN THE WORLD OF TV SETS, THIN is in as a parade of flat-panel wonders become the darlings of the boob-tube-watching masses. And as the industry undergoes its biggest makeover since the advent of color, the U.S. winners may well be the chipmakers that supply the top TV brands and discount models alike.

The easiest bet is Texas Instruments. In the fast-growing market for digital light-processing, or DLP, projection TV, TI is the only game in town. The chipmaker's DLP business represents 8% to 10% of its \$12.6 billion in sales, up from virtually nothing just two years ago. Thanks in part to this business, TI is en-

joying a 55% jump in 2004 earnings, which will moderate to a 25% gain in 2005, predicts analyst Rick Whittington at brokerage firm Caris & Co. He rates

the stock a bargain at 21 times its estimated 2005 earnings, compared with its 10-year average of 29.

Investors looking for a promising smaller player can size up graphic chipmaker ATI Technologies. Already a leader in high-end graphics cards for personal computers, Thornhill (Ont.)-based ATI has branched into the digital TV and cellular-handset market, a smart move if PC sales sink next year, as some expect. Motorola Inc.'s sleek Razr V videophone sports ATI's Imageon processor, while many TV makers are baking ATI chips into built-in set-top boxes. ATI trades at 19 times 2004 earnings estimates, but Goldman, Sachs & Co. analyst Andrew Root expects its price-earnings ratio to rise to 29 in 2005.

As the demand for flat-panel TV zooms, so does the market for the chip that grab TV signals out of air and decode the stunning, crystal-clear picture of these flat screens. One of the leaders is Sunnyvale (Calif.)-based Zoran Corp. is not cheap at nearly 34 times estimated 2005 earnings. Still, it now trades at just under half its 52-week high, which may present a buying opportunity. Zoran took a tumble in October after it lowered its fourth-quarter forecast because of increasing inventories of DVD chips. But the company is working to wean itself from that price-sensitive market and move into higher volume digital TV and cell-phone chip sales.

These bets could fail if the economy falters and consumers figure their analog TVs will suffice. But little looks likely to rain on this parade, and chipmakers will go along for the ride. ■

Screening for Buys

COMPANY/SYMBOL	PRICE*	P-E RATIO**
TEXAS INSTRUMENTS TXN	\$23.63	21
Big in digital light-processing chips, is now moving into cell-phone TVs		
ATI TECHNOLOGIES ATYT	19.61	19
Leading supplier of graphics chips for digital TVs, set-top boxes		
ZORAN ZRAN	11.16	34
A leader in decoder chips for signals in digital TVs and set-top boxes		

Data: Bloomberg



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Hungry, Hungry Bankers

In a crowded market, here are the top targets and suitors. **BY MARA DER HOVANESIAN**

NEVER MIND THAT thousands of banks have been bought up in the past decade. The market is still too crowded. So big and midsize banks will continue to get bigger by swallowing up smaller ones. Megamergers are always possible, but small, regional banks are the target of choice to pump growth—which is slowing as interest rates rise and as the mortgage business cools. “It’s a consolidating industry,” says Jackie Reeves, a senior analyst at Ryan Beck & Co., a Livingston (N.J.) investment bank and brokerage specializing in financial services. “There are too many players.”

Acquisition targets usually see their stock prices rise: So which of the takeover candidates offer the biggest payoff for investors? In an exclusive study for *BusinessWeek*, Ryan Beck drew up a list of the most promising prospects. The banks that might fetch the highest premiums often operate in competitive metropolitan markets, where they have low market share. They sometimes have senior executives on the verge of retirement but without clear successors. The best of them have a strong branch network, a healthy base of deposits, a diversified portfolio of loans, and often strong credit-quality controls.

Topping the list is Philadelphia’s Sovereign Bancorp Inc. It has grown rapidly through acquisitions, but its financial performance hasn’t matched that of its peers, says Ryan Beck senior analyst Collyn Gilbert. That, coupled with a weak stock, down 7.8% in the past year, “could prompt shareholder discontent and ultimately a sale,” he says. An investor buying in at today’s price of nearly \$22 could scoop up a 59% total return over the next 12 months if Sovereign is bought at its es-

timated takeover value of \$35.

Other chronic acquirers seem to have reached a limit in their ability to absorb other players and they may now become targets themselves. Consider Fulton Financial, based in Lancaster, Pa., which operates branches in Pennsylvania, Delaware, Maryland, and New Jersey, and whose chief executive is set to retire in October. Fulton ranks second on Ryan Beck’s list, promising a 45% total return over 12 months if it’s taken over.

Most of the banks and thrifts on the list are based in high-growth states. Two in Birmingham, Ala.—Regions Financial and Amsouth Bancorporation—could also be up for grabs, and would get a sweet price, says Ryan Beck. Likely suitors might include regional powerhouses such as Wachovia, SunTrust Banks, BB&T, and Fifth Third Bancorp., according to Ryan Beck analyst Steven C. De-

Laney. He doesn’t rule out bidding wars.

Some bigger banks with a strong focus in the Northeast could also end up on the block over the next year. Senior bank analyst David A. Hendler of New York research shop CreditSights says many of these potential targets come cheap. One bank that does not show up on Ryan Beck’s list is Pittsburgh’s PNC Financial Services Group, which sells for 12 times estimated 2005 earnings, says Hendler. The bank could be an East Coast entrée for Wells Fargo or U.S. Bancorp. In addition, Cleveland’s KeyCorp and National City might find themselves on someone else’s shopping list.

As the M&A trail rolls on, no doubt some bankers will resist selling. Some will continue to thrive by offering customers superior service. But many bankers will find it hard to refuse a top-dollar offer in what will remain a challenging climate.

Banking on a Deal

As consolidation picks up in banking, some small and regional outfits look like prime takeover candidates:

COMPANY/ SYMBOL	PRICE	EST. TAKEOVER VALUE	POTENTIAL 12-MO. TOTAL RETURN**
SOVEREIGN BANCORP SOV	\$21.74	\$35	59%
FULTON FINANCIAL FULT	22.10	32	45
AMSOUTH BANCORPORATION ASO	25.41	35	38
FIDELITY SOUTHERN LION	18.27	24	34
COLONIAL BANCGROUP CNB	20.82	28	33
FIRST HORIZON NATIONAL FHN	42.70	56	31
REGIONS FINANCIAL RF	34.90	45	31
HUNTINGTON BANCSHARES HBAN	23.89	31	32

*Data by *BusinessWeek*. **Data by Ryan Beck & Co.

FILLING UP Oil stocks are one road to China's consumer sector



Four Countries You Must Own

Every investor needs a stake in Brazil, Russia, India, and China. **BY CHRISTOPHER FARRELL**

ONCE IN A GREAT WHILE a trend takes hold that's so powerful, it transforms the entire global economy: the Industrial Revolution of the 18th century, the modern industrial nation in the 19th century, and the emergence of cheap computing and communications in the 20th century.

The newest megatrend? It's the rise of the BRICs. That's shorthand for four dynamic developing nations with large populations—Brazil, Russia, India, and China. The four now account for less than

15% of the economies of the G6 nations (page 104, chart). But collectively they could be larger than the G6 in just four decades, say economists at Goldman, Sachs & Co. That depends, of course, on whether they get the fundamentals right: sound fiscal and monetary policies, free trade with the outside world, and massive investment in education. "It's a story for the future," says Robert Hall, portfolio manager for global emerging markets at Russell Investment Group.

That means you might want to start making investments now. You can choose individual equities or take a bas-

ket-of-stocks approach with exchange-traded indexed funds or actively managed mutual and closed-end funds (page 104, table). Don't invest a huge lump sum at once. Instead, put your money in over time. The markets are volatile, and there will be pullbacks offering cheaper entry points.

These economies have weaknesses, too. For instance, foreign capital is pouring into China so quickly that some economists fear the combination of a speculative frenzy and a backward banking system will eventually burst the bubble. Watchdog group Transparency International ranks India among the rampantly corrupt nations in its latest Corruption Perception Index. And investors are questioning Russian President Vladimir Putin's commitment to capitalism after the recent crackdown on oil giant Yukos. Any one of those could derail the markets or the economy for a bit.

Still, there is precedent for making a long-term bet on an emerging frontier. In the years after the Civil War, America's industrial output lagged far behind that of Germany, France, and Britain. Yet from 1870 to 1914, America's economy expanded fivefold, and the U.S. became the world's leading industrial power. Along the way there were about a dozen sharp

The Best Plays Developing Giants

downturns and a handful of financial panics, yet stocks returned an average of 6.5% a year after inflation. "If you can close your eyes for years, you'll probably do well," says Stuart Schweitzer, global markets strategist at JPMorgan Fleming Asset Management in New York.

In part driven by the economic performance of the BRICs, the entire emerging-market sector put on a stellar show this year. The Morgan Stanley Capital International Emerging Market Index is up some 14% through Dec. 10, vs. 6.8% for the Standard & Poor's 500-stock index.

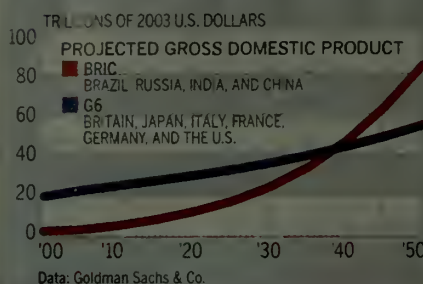
And 2005 looks good, too. Emerging-market stocks are cheap, with valuations about 40% lower than in the U.S. The sinking dollar is prompting investors to send more money abroad, says Brad Durham, a managing director at Emerging Portfolio Fund Research in Boston. Currently, global mutual funds and pension funds are underweighted in the BRICs. As investors become more familiar with the BRICs, says Durham, more money will flow to them.

One strong global theme that benefits the BRICs in particular is demand for industrial commodities. Brazil's Bovespa stock index is up some 15% this year, powered by companies such as Companhia Vale do Rio Doce, a major exporter of iron ore, and CSN, a major steelmaker. Rio Doce, CSN, and other basic industry companies should continue to do well considering the world's voracious appetite for raw materials, especially in China. Russia's Gazprom, for instance, will account for a quarter of world gas production, and it will be one of the international oil giants after buying a chunk of rival Yukos. "It's Russia's Aramco," says James Fenkner, chief strategist for Troika Dialog, a Moscow investment bank, referring to the Saudi Arabian oil company. "You don't need to be born into the House of Saud to benefit from Gazprom."

While commodities are expected to remain strong, many global investors believe rising incomes and growing employment in the BRICs will make consumer companies golden. In a decade, say the Goldman

Coming On Strong

As a group, the economies of Brazil, Russia, India, and China (BRIC) are growing faster than those of developed nations. That growth should result in good opportunities for astute investors.



economists, the BRICs' middle class will total more than 800 million, greater than the populations of the U.S., Western Europe, and Japan combined today. The BRICs' middle class now number more than 250 million, says Goldman, and

those consumers are already spurring demand for cars, cell phones, and better food, furnishings, and clothes.

Investing in the consumer sectors of these countries has been hard because of a scarcity of good, publicly traded companies. But that's changing. New opportunities are opening in Brazil, for example, after a rash of initial public offerings there. Among the IPOs were Natura cosmetics company, and Grendene, footwear maker. In Russia, mobile-phone companies such as Mobile Telesystems are benefiting from growing usage. When Putin came into office in 2000 there were some 1.5 million cell-phone subscribers in Russia. Now there are more than 50 million. India's Pantaloon Retail is building both food hypermarkets and clothing stores that appeal to young buyers. Sam's store sales are expanding at a 12% to 15% annual pace.

FOOLHARDY—OR FARSIGHTED?

IN CHINA, CONSUMERS are also investing in savers, salting away some 40% of their income. That's good for financial-services firms such as China Life Insurance, a favorite of Agrifund, an investment manager for Standard Life Investments in Hong Kong. China Life is the country's biggest insurer and its premium income is growing at 15% a year. Phil Ehrmann of Gartmore China Opportunities Fund, a U.S. mutual fund, expects a number of state-run Chinese banks to go public in 2005 and they may make attractive investments. You heard that right. China's banks have a reputation for bad loans and poor management, says Ehrmann, but he thinks some of them will clean up their act because the government wants them to go public.

For sure, those who invest in those Chinese banks—or the BRICs—will be called foolhardy by some doubters. But much the same was said in the 19th century about those who invested in a wild and raucous nation called America. ■

—With Frederik Balfour in Hong Kong, Jason Burt in Moscow, and Jonathan Wheatley in São Paulo

A Portfolio for the Future

Sure, there are risks, but you can't ignore these up-and-coming economies. You can buy individual stocks or take a more diversified approach via closed-end or exchange-traded funds.

STOCK/SYMBOL	SECTOR	PRICE*
Brazil		
COMPANHIA VALE DO RIO DOCE RIO	Mining	\$24.67
CSN SID	Steel	17.10
GOL LINHAS AEREAS GOL	Airlines	27.58
ISHARES BRAZIL EWZ	Diversified	20.48
Russia		
GAZPROM OGZPF	Energy	35.00
MOBILE TELESYSTEMS MBT	Telecom	127.99
SIBNEFT SBKYY	Energy	26.50
TEMPLETON RUSSIA FUND TRF	Diversified	58.88
India		
ICICI BANK IBN	Financial Services	19.00
INDIA FUND IFN	Diversified	28.38
INFOSYS TECHNOLOGIES INFY	Technology	66.68
MORGAN STANLEY INDIA FUND IIF	Diversified	27.45
China		
CHINA LIFE INSURANCE LFC	Insurance	28.50
CHINA TELECOM CHA	Telecom	35.45
FIDELITY CHINA REGION FUND FHKCX	Diversified	16.48
ISHARES FTSE/XINHUA CHINA 25 FXI	Diversified	54.03

Data: Bloomberg Finance Markets Research, as of Dec. 10

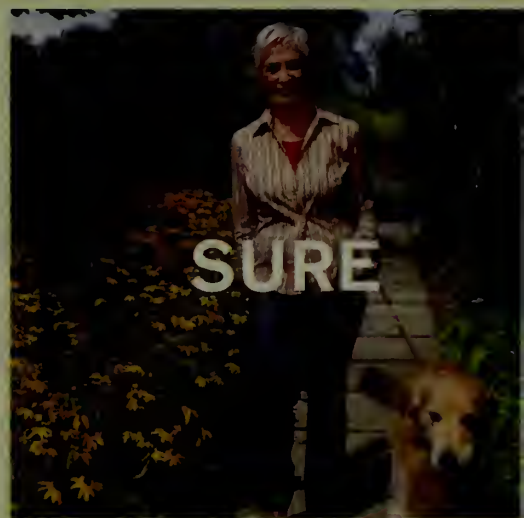
PLANNING FOR RETIREMENT ALWAYS OUTPERFORMS WORRYING ABOUT IT.



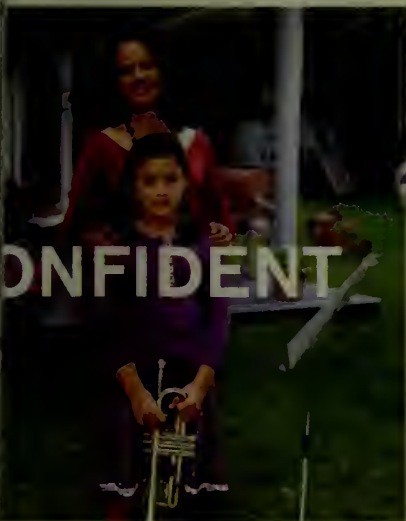
UPBEAT



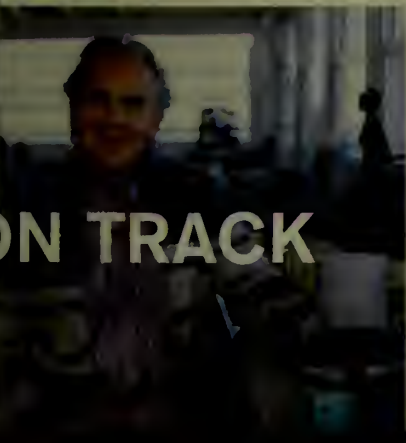
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Alternative Energy Gets Real

Pricey oil and gas are heating up industrial interest in renewable sources. **BY JOHN CAREY**

RENEWABLE ENERGY IS booming. The use of solar power has been growing by more than 30% a year and, except for a hiccup in 2004—when Congress delayed renewing a tax credit—so has wind power. Ethanol is heading for record production levels. And there's no end in sight, given high oil and gas prices, an increasing number of government mandates and incentives, and the first real steps toward tackling global warming. Clean Edge Inc., a research and strategy consultant, predicts that the total clean-energy market will grow to \$92 billion by 2013, about seven times its current size of \$13 billion. "The investment community is starting to see real opportunities," says Ron Pernick, co-founder of Clean Edge.

But buyer beware: Many of the leading companies supplying the technology to produce renewable energy still aren't profitable. Often the pros are divided on just which are the leading companies. In fact, today's renewable business is remi-

niscant of the computer industry in the early 1980s, "when no one knew who the winners would be," says Carsten Henningsen, chairman of Portfolio 21, a mutual fund that invests in environmentally conscious companies. That's why

many analysts and fund managers recommend investing in a basket of companies. "People should try to pick companies positioned to be winners and get enough of them," says Henningsen.

Wind might produce the biggest winners. A U.S. tax credit of 1.8¢ per kilowatt hour is in place until 2006, and 19 states now require electricity producers to generate part of their power from green sources. Energy information and service company Platts, like *BusinessWeek* part of The McGraw-Hill Companies, expects that most of the new sources will be wind. One beneficiary could be Denmark's Vestas Wind Systems, the world's biggest turbine manufacturer, which is listed in Copenhagen and trades over the counter in the U.S. "It is profitable, and there's more certainty and a more favorable political climate surrounding wind than solar or hydrogen," says Henningsen.

Fuel-cell companies are also catching the eye of investors. Their stock prices are way down from the speculative peaks of a few years ago, but the products are finally becoming a compelling alternative to diesel-powered backup generators, says Walter Nasdeo, managing director of New York-based Ardour Capital Investments LLC. And they hold the promise of clean, efficient, hydrogen-powered cars, provided costs come down. Nasdeo is bullish on FuelCell Energy Inc., which he expects to reach \$17.50 in price, from \$8.45 now.

A buy-and-hold strategy combined with some selective trading may be the best strategy for cashing in on the alternative-energy boom. "If [FuelCell Energy] goes to \$14 or \$15, you should take

Power Players

COMPANY/SYMBOL	PRICE*	P-E**
VESTAS WIND SYSTEMS VWSYF.PK World leader in wind turbines but faces stiff competition.	\$10.85	17
ACTIVE POWER ACPW Makes flywheel-backup power systems. Its cheap stock could be a buying opportunity.	\$4.54	NA
EVERGREEN SOLAR ESLR A rare pure play in solar, with new, thin-silicon technology.	\$3.33	NA
IMPCO TECHNOLOGIES IMCO Should see more demand from carmakers for its systems, which enable autos to run on alternative fuels.	\$6.06	24
FUELCELL ENERGY FCEL Makes fuel cells to replace generators, a key market for the promising technology.	\$8.45	NA

*Dec. 10
Data: Bloomberg Finance Markets
**Based on forecast revenues for fiscal 2005



THIS IS NOT SPEND MANAGEMENT.

ARE DIFFERENT DEPARTMENTS CONTRACTING THE SAME SERVICE AT MULTIPLE RATES?

Every day, millions of dollars are inadvertently lost due to inconsistent spend contracts—ranging from temp labor hires to facilities maintenance. When you institute best practices to regulate your procurement of services, that's Spend Management. And that's Ariba. We can help set standards that help everyone work smarter and transform your business. To get your complimentary copy of our "Five Step Guide to Services Spend Management Success", please call us at 1-866-772-7422 or visit www.ariba.com/service.

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little profit, then wait until [it] pulls back and buy some more," says Nasdeo. Eventually, he expects one of the renewable energy stocks to hit it big. In addition to FuelCell Energy, Nasdeo sees potential in Evergreen Solar, which makes solar cells; American Superconductor, which makes highly efficient superconducting wire and power-regulation devices; and two other fuel-cell makers, Hydrogenics and Plug Power.

Portfolio 21's Henningsen also sees opportunities now to buy companies with beaten-down stocks. His own holdings: Vestas; fuel-cell makers Ballard Power Systems and Plug Power; and IMPCO Technologies, which focuses on devices

EARLY 2005 WILL SEE THE DEBUT OF A FUND THAT SPECIALIZES IN RENEWABLE-ENERGY STOCKS

for car engines that use alternative fuels. After a fall for these stocks in 2004, "now may be the time to buy," he says.

If investors don't have the time or stomach to juggle a portfolio of individual

stocks, they could buy into a fund that specializes in renewable-energy stocks. An interesting choice is the Wilder Clean Energy Index, set to debut in early 2005. It's the brainchild of Robert Wilder, who put together an index of clean energy stocks five years ago as a hobby. It now includes everything from fuel-cell companies to suppliers of carbon fiber for turbine blades and makers of hydrogen. The index soared during the tech boom, plunged, and is now up 26% since August. "There are about 40 representative stocks—and any one of them might do well," says Wilder. In other words, with a big enough basket, renewable energy could charge up any portfolio.

WINNERS

Grabbing a Piece of The Nuclear Action

During a recent test at an experimental nuclear reactor in China, engineers did their best to create a disaster. They cut off the flow of the coolant that removes heat from the nuclear reaction, then withdrew the control rods. That's a recipe for a meltdown in today's plants. But this reactor quickly shut down on its own with zero damage. "It was unbelievable," says Massachusetts Institute of Technology nuclear engineer Andrew C. Kadak, who witnessed the demonstration. "It is why I have such confidence in this technology."

The dramatic test is just one sign of the rising prospects of once-despised nuclear

power. Both China and South Africa plan to build a group of advanced power plants, and other countries are seeing nukes as a way to insulate themselves from rising natural gas and coal prices—and to meet new curbs on carbon dioxide emissions. In the U.S., public support is the strongest in years. And utilities and nuke builders plan to spend hundreds of millions on the design and engineering work needed to get approval for a new generation of plants.

One of the few nuclear pure plays for investors is Bethesda (Md.)-based USEC Inc., the world's leading supplier of enriched uranium fuel for commercial nuclear power plants. The \$1.4 billion company operates the only enrichment facility in the U.S., in Paducah, Ky. It's now building a demonstration plant for new enrichment technology in Piketon, Ohio, which is set to begin operations in 2005.

The U.S. has 103 nuclear plants. Investing in some of the utilities that run them, such as Exelon, Entergy, and Dominion Resources, is one way of playing the nuke trend, says David M. Schanzer, analyst at Janney Montgomery Scott. "If you believe nuclear power is a path to the future, we think these companies make perfect sense," he says. Following the big runup in energy



IMPROVED IMAGE
Big gains ahead for nuke stocks?

stocks, these companies are "fully valued," he says. But over the long term, he expects them to outperform others in the industry.

Another way to get a piece of the nuclear action is to invest in the big companies that would design and build plants. Two are General Electric Co. and Westinghouse Electric Co., now a subsidiary of British Nuclear Fuels PLC.

Certainly, there are plenty of risks. There's a long road before any new U.S. plants go online, even if the industry resolves its most vexing problem: how to store the waste that plants generate. But if the favorable climate for nukes continues, the industry believes it could add 30 to 50 plants by 2020, at a total cost of \$50 billion to \$125 billion. With such growth, going nuclear could pay off.

—By John Carey in Washington

Betting on Nukes

COMPANY/SYMBOL	PRICE*	P-E**
EXELON EXC Has 17 nuclear power plants—the biggest commitment to nuclear power	\$41.98	14
ENTERGY ETR Along with Exelon and others, is working to develop the next generation of plants	65.10	14
DOMINION RESOURCES D Richmond (Va.)-based utility is looking to design new plants	67.50	13
USEC USU Leading supplier of fuel has new, though unproven, technology for enriching uranium	9.64	35

*Data from BusinessWeek.com
Data as of 12/22/04

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The railroad industry is steeped in tradition, but the skill set required to keep this economic engine on track is far from traditional. "Railroads are complex networks. It's data, not locomotives, that drive goods to where they need to go," says Eric. It was at Carnegie Mellon that he honed his analytic know-how. "At Tepper, I learned never to shy away from complexity. Rather, I leverage analysis to build consensus and drive change."

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How to Seize a *Gran Oportunidad*

Capitalize on the growing Latino market with health-care, financial, and media companies that target these consumers. **BY BRIAN GROW**



THIS WON'T HURT
Molina Healthcare
a leading HMO
for Hispanics

ANY ECONOMIST WILL tell you “demographics is destiny.” If you look at the Hispanic population, nearly 40 million strong and growing almost three times faster than the U.S. population as a whole, there’s no question it’s destined to be a powerful economic force (table, page 108). In fact, it already is. Incomes for Hispanics still trail the national average, but they are gaining fast. Total disposable income is up 29% over the past three years, and it’s expected to top \$1 trillion by 2010. Serving a market that’s fast-growing in both size and wealth presents a huge opportunity for many companies and their shareholders.

The best way to put this salsa in your portfolio is to invest in health-care, financial, and media companies that target Hispanic consumers. “These firms’ revenues are growing three to four times faster” than their industry averages, says Jay C. Garcia, managing director of Samuel A. Ramirez & Co., a New York investment firm.

IPOs ON THE WAY

IN FACT, HOT PICKS in the Hispanic market are becoming easier to find. While most publicly traded companies founded by or receiving more than half their business from Hispanics are still covered by regional analysts, they are drawing the attention of big investment banks. The reason: More than 27,000

Hispanic companies now have revenues of \$1 million or more, and dealmakers are salivating at the prospect of future initial public offerings. Twenty-two have gone public over the past five years, from Cuban-owned communications equipment supplier MasTec Inc. to Florida-based radio equipment company Spanish Broadcasting System. Eleven of those are now featured in the Ramirez & Co. Hispanic index, a benchmark for Hispanic stock performance with a stellar record. The RCHI has risen 177% since its inception in 2000, compared with a 17% decline in the Standard & Poor’s 500-stock index. “It’s a great time to invest in what is the second-largest demographic shift in the country after the retir-

ing of the baby boomers,” says Carlos L. Signorini, a partner in Hispania Capital Partners, a Chicago private-equity firm specializing in Hispanic companies.

The hottest Hispanic-run company in terms of revenue, earnings, and stock price growth is Molina Healthcare Inc., a provider of health plans and clinics for Medicaid-eligible citizens, says Ramirez & Co.’s Garcia. Chronically underinsured after coming to the U.S. because few Latin American countries have a tradition of health insurance, low-income Spanish speakers account for more than a third of the Medicaid population, says Molina’s Chief Executive Officer J. Mario Molina. With more than 300,000 new Hispanic immigrants entering the U.S. each year, the ranks of Hispanics using govern-



moving forward ▶

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The Best Plays Hispanics

Hispanics as an Economic Force

Some plays that serve Latinos may be good bets. Here's why:

Data: U.S. Census Bureau; Columbia Sachs & Co.; University of Georgia; Vestar Capital Partners

FAST-GROWING POPULATION

40 million people, growing 2.9% per year, vs. 1% for total U.S. population

YOUNG BUYERS

34.4% of the Hispanic population is under 18, vs. 22.8% for non-Hispanics

MORE WEALTH

Hispanics' disposable income is up 29% since 2001, to \$652 billion, and will top \$1 trillion by 2010

ENTREPRENEURIAL SPIRIT

More than 27,000 Hispanic-owned companies now have revenues of \$1 million or more

ment-sponsored health care are growing rapidly. That has helped push membership in the Long Beach (Calif.) health-maintenance organization up 40% this year, to about 800,000 customers paid for by Medicaid. The stock trades near a 52-week high. But with a price-earnings ratio of 19 and earnings expected by analysts to grow 22.5% in 2005, it remains relatively cheap. "Molina is becoming the Hispanic health-care provider of choice," says Garcia.

If health care for the poor seems too risky, try banking. By offering financial services such as mortgage lending and bank accounts, San Juan (Puerto Rico)-based Doral Financial Corp. is able to tap two big trends: the rising rate of Hispanic homeownership and the number of new Latino immigrants eager to keep their cash in the bank instead of under the mattress. Doral already dominates the home-loan market in Puerto Rico. Doral's recent push into New York—where it plans to target stateside Riqueños as well as Dominicans and other nationalities—gives the bank substantial upside potential. Analysts expect Doral will earn \$4.50 per share next year, up from \$3.88 in 2004. That's a 16% jump, yet the price-earnings ratio for 2005 is just 10.2. Says Audrey L. Snell, senior vice-president and head of research at New York investment bank Brean Murray & Co.: "Their p-e is puny, and it doesn't reflect the firepower and momentum of the business."

TUNING INTO UNIVISION

PERHAPS THE BEST-KNOWN Hispanic-oriented investment is Univision Communications Inc. The largest Hispanic media conglomerate in the U.S. reaches 98% of the Latino population. The company has been catering to Spanish speakers for decades with a mix of supercharged soccer games, campy *telenovelas*, and glitzy variety shows. Univision profits have grown a total of 73.4% in the past five years.

Now may be the time to buy Univision. The stock is trading near a 52-week low

on concerns that growth could slow in its television unit. But with profits up 74% in the third quarter year-over-year, to \$73 million, some investors say those worries are overblown. "Univision is huge and has a powerful future," says Federico F. Peña, former Transportation Secretary and Energy Secretary in the Clinton Administration, who now oversees Hispanic investments for private-equity firm Vestar Capital Partners.

Peña's bullish on Univision and TV station operator Entravision Communications Corp. because their ad revenues will

grow faster than the industry's. The Hispanic media get only 4% of total ad revenues, far below the 14% Hispanic share of the total population. He's betting the share will grow for all Hispanic media. "The ad revenues being placed in the [media] companies are not yet commensurate with their viewing audience," says Peña.

Not all the plays are companies with Hispanic roots. Analyst David J. Kostin of Goldman, Sachs & Co. says Avon Products Inc., longtime No. 1 cosmetics purveyor in Latin America, is profiting from the Hispanic boom in the U.S. Nearly 30% of U.S. Hispanic women buy cosmetics through direct-to-home sales, vs. 21% of non-Hispanic women. That preference has helped push Avon sales to Hispanics up 11% in 2002, to \$330 million, or 5% of Avon's \$6.2 billion in worldwide sales. (Avon stopped disclosing sales to U.S. Hispanics last year.) This fall the company scored Mexican actress Salma Hayek as a new global pitchwoman. Despite warning on Dec. 8 that domestic sales will struggle overall in the new year, Avon executives expect U.S.-based Hispanics to continue buying in a big way.

Kostin also says large banks with a high share of deposits in Hispanic havens such as California, Texas and Florida will benefit. In that category, Bank of America Corp. and Wells Fargo & Co. stand out. "All these companies are riding the Hispanic wave," says Monika I. Mantilla, head of the capital committee at the New America Alliance, a Latino business group, and principal in an investment firm with \$2.5 billion under management.

As Wall Street's big guns turn their attention to Hispanic stock, the sector could become more volatile. Still, those who want to participate in this important demographic trend should buy and hang on for the ride. Investors should have some *buena suerte* in this sector. ■



Spice Up Your Portfolio

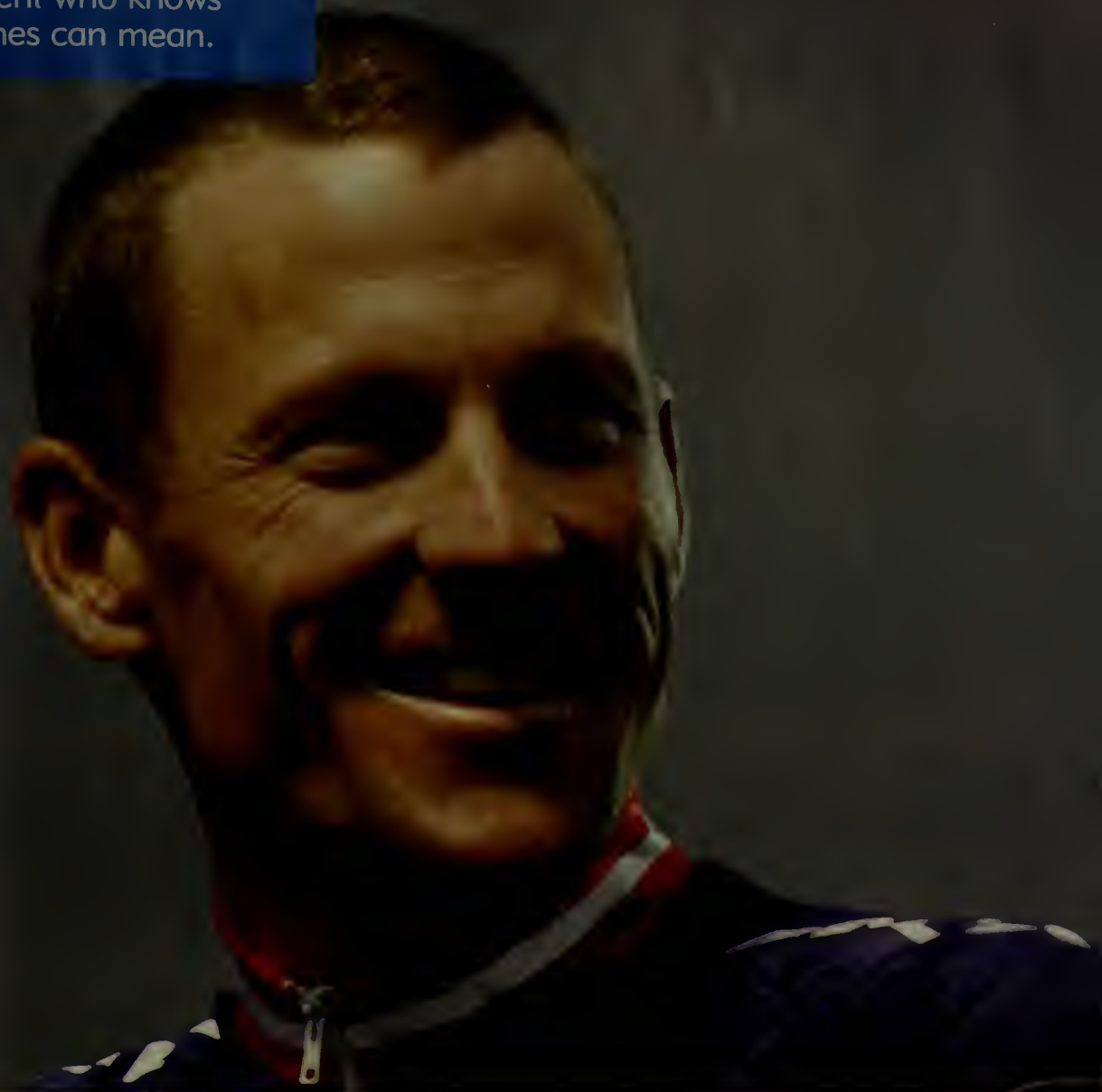
COMPANY/ SYMBOL	PRICE*	PRICE-EARNINGS RATIO**
AVON PRODUCTS AVP	39.53	20
U.S. cosmetics giant, also No. 1 in Latin America, profiting from sales to immigrant Latinas		
DORAL FINANCIAL DRL	45.88	10
Already tops in the Puerto Rico mortgage market, now expanding to Hispanic homeowners on the mainland		
MOLINA HEALTHCARE MOH	45.50	19
Runs health plans and clinics for the poor; profits expected to jump 20% next year		
POPULAR BPOP	27.03	13
Now the No. 31 bank in U.S., selectively gobbling up banks in states with lots of Hispanics		
UNIVISION UVN	27.90	32
Grand champion of Hispanic media companies and still set for earnings to grow 20% next year		

*Dec. 10. **Based on consensus earnings forecasts for the next 12 months.
Data: Ramirez & Co.; Goldman Sachs; Raymond, James

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Hope, Triumph, and the Miracle of Medicine



Why Collectors Are Crazy For Chinese Art

It's not only dynastic porcelain vases. Art mavens are buying contemporary works as well. **BY THANE PETERSON**

BACK IN THE 1960S AND 1970s, when Jim Eccles was working as an IBM systems engineer, he fell in love with the work of the late Chinese artist Chao Chung Hsiang, who was then living in New York. Now 69 and retired, Eccles still loves the seven colorful paintings, some abstract and others in a more traditional Chinese style, that he bought for \$200 to \$500 each. But lately he has thought about selling them. Based on recent auction sales, he figures they can fetch \$50,000 to \$100,000 each.

With the emergence of free-spending, nouveau riche collectors from mainland China, the Chinese art market is at the start of what may be an extended boom. Buyers are snatching up everything from 3,000-year-old bronze vessels to avant-garde paintings by Chinese-born artists living in China and abroad. Ever since more than 50 Asian bidders, many from China, showed up at a seminal September, 2003, sale of Chinese rarities at the Doyle auction house in New York, prices

have been surpassing estimates. Some examples: At this fall's Hong Kong sales, a 1947 ink scroll by the painter Fu Baoshi, who died in 1965, sold for \$1.1 million, four times as much as Sotheby's predicted. On Nov. 17, London dealer Giuseppe Eskenazi, who often buys for European and American collectors, paid a record \$5.7 million for an 18-inch early Ming Dynasty dish at a Bonhams & Butterfields auction in San Francisco.



PRIZED Qing Dynasty vase



GREAT VARIETY A painting by "China's Picasso," Zhang Daqian, and a detail from a larger work by Zhang Huan

Art collecting was one of the "bourgeois" activities purged in the 1960s and '70s during the Cultural Revolution, but it has flourished under recent economic reforms. Dozens of art auction houses have sprung up in China in recent years, the most prominent of

which is China Guardian in Beijing.

Experts expect prices to continue rising as China's wealth grows. "The Chinese don't understand why there's such a big price difference between Western art and the greatest Chinese art," says Henry Howard-Sneyd, Sotheby's Hong Kong-based managing director for China and Southeast Asia. For instance, while a Picasso painting sold this spring for \$104 million, works by Zhang Daqian, who lived from 1899 to 1983 and is known as China's Picasso, usually top out at about \$1 million. Chinese collectors figure Zhang's paintings should eventually approach Picasso's level.

Is it too late for smaller collectors to dive in? "Oh, God, no," says David Tang, the Hong Kong entrepreneur and art collector who argues that the rise of the Chinese art market "is just beginning."

Before you make any purchases, there are a few things you should know. It's important to buy through reputable dealers. Fakes and copies are rife, particularly of classic paintings and furniture, and even experts can be fooled. If you're buying within China, stick to recent works. It's illegal to export paintings and artifacts dating before 1949.

One way of approaching the market, says Theow Tow, New York-based deputy

chairman of Christie's Americas, is by "looking for categories where mainland Chinese haven't started buying yet but probably will." For instance, Qing-era (1368-1644) and Ming-era (1644-1911) ceramics have soared, in part because Asian buyers most prize later works connected to the Chinese emperors. But experts say Song Dynasty (960-1269) ceramics remain relative bargains. A small 13th century Song Dynasty bowl went for \$2,390 at Christie's in Hong Kong on Sept. 21.

CROUCHING RABBIT

WORKS IN STONE and pottery from the Han (206 B.C.-220 A.D.) and Tang (618-907) periods remain comparatively cheap. For example, Eskenazi has a small stone Tang-era sculpture of a crouching



NEWLY RICH COLLECTORS FROM THE MAINLAND ARE CAUSING PRICES TO JUMP

rabbit on sale for \$23,000. Chinese furniture with imperial connections commands a huge premium: A Qing Dynasty bed made from exotic hardwoods went for \$847,500 at a Christie's sale in New York in September. But older softwood

pieces with no imperial associations sold for as little as \$5,000. Some small collectors specialize in Chinese snuff bottles, which sell for \$2,000 on up. Check out Christie's snuff bottle sale in March, 2005, and the selection of London dealer Robert Hall at www.snuffbottle.com.

You can also find bargains in China's far-out contemporary art. Prices for the best known artists, such as 39-year-old Zhang Huan, have soared to \$40,000 and up. Zhang, who lives in New York, often uses his own body as a canvas and sells photographs of his work. But many promising artists remain affordable. A top pick of Kent Logan, a retired securities executive in Vail, Colo., who owns 120 contemporary Chinese works, is 30-year-old Zhao Bo of Chongqing, in south-central China's Sichuan province. His jazzy street scenes sell for \$700 to \$9,000 or so. Julia Colman, co-owner of London's Chinese Contemporary Gallery, which sells Zhao's paintings, also likes painter and photographer Zhang Dali, 41, who documents the social stresses caused by China's modernization. His pieces start at \$6,000.

If this art appeals to you, start thumbing through catalogs, visiting galleries, and studying Web sites of galleries and impor-

tant shows. Dealers with expertise in Chinese art include Eskenazi Ltd. (eskenazi.co.uk) and J.J. Lally in New York for classic ceramics and pottery; Kaikodo in New York (kaikodo.com) and Alisan in Hong Kong (alisan.com.hk) for traditional paintings; and Chinese Contemporary (chinesecontemporary.com) in London, Ethan Cohen Fine Arts in New York (artnet.com/ecohen.html), and the Hanart gallery in Hong Kong (hanart.com) for avant-garde pieces. If you see something you like, don't dally. As Jim Eccles discovered, prices are rising as we speak. ■

HUGE PREMIUM 18th century bed sold by Christie's

Smart Strategies

To make big gains in 2005, you'll need to be more creative

THE UNIVERSITY WITH DIVERSITY >> P. 118

Learning from Harvard Management, which has racked up 15.9% average annual returns

HARVARD'S MONEYMAN >> P. 119

A talk with Jack Meyer, who manages \$27 billion for the university

MARGINS TO MARVEL AT >> P. 120

Some companies have the knack for turning in healthy profits in good times and bad. Meet the All-Stars

CASH-HEAVY COMPANIES >> P. 122

Plenty of businesses have let the green stuff pile up. Here are some that use it wisely

PROTECTING YOUR HOME >> P. 126

Even if fears of a bubble are overblown, get ready to think defensively

HOW TO GET MORE FOR YOUR MONEY >> P. 131

With interest rates still low, it's hard to get a respectable return. But if you're willing to take a little risk...

SQUEEZE THOSE STOCKS >> P. 136

Want extra income from your existing portfolio? Try selling covered call options

JACK BLACK





How to Invest Like Harvard

There's "not much plain vanilla" in the university's portfolio. **BY WILLIAM C. SYMONDS**

JUST AS MOST COLLEGES look up to Harvard University, most investment managers look up to Harvard Management Co., the in-house firm that manages \$27 billion for the university. Over the past decade, Harvard has posted a 15.9% annual return, vs. just 10.1% for the median large institutional fund. That feat has generated an extra \$12.2 billion—nearly as much as the entire endowment at Yale University, the second-wealthiest. Says James Swanson, chief investment strategist at MFS Investment Management: "They are the Mickey Mantles of the investing world."

Harvard Management has achieved

this with a formula that bears little resemblance to that of the average investor. "There's not much plain vanilla in our portfolio," says Chief Executive Jack R. Meyer, who got the university to adopt a model portfolio soon after he arrived from the Rockefeller Foundation in 1990. Today it calls for investing just 15% of the fund into U.S. stocks, and 11% into conventional U.S. bonds, far less than is usual for individuals or most institutions.

Meyer's core strategy is diversification

writ large. He and the 175 pros who work with him cast their net far and wide—from private equities and hedge funds to real estate, commodities, and foreign stocks and bonds—in their search for investments that don't move in step with each other. Harvard also puts just as much money into foreign and emerging stocks combined as it does into U.S. equities. And its bond portfolio covers the waterfront. "When I say bonds, I don't just mean conventional U.S. bonds," says Meyer. "But also foreign bonds, high-yield bonds, TIPS [Treasury inflation-protected securities], and emerging-market debt."

The diversification strategy doesn't preclude huge bets. Meyer's model portfolio calls for 13% in commodities—along with hedge funds and the like, the second biggest class of investments on his menu. But about 77% of Harvard's

A Harvard Education

The school's success in expanding its endowment holds lessons for individuals:

- Seek out the best managers because there's a huge difference between them and the ones who are just competent, especially in private equity.
- Pick investments that are not correlated strongly to each other. Foreign stocks often track U.S. stocks, while commodities and real estate don't.

education to commodities is invested in timber. "It's one of my favorite asset classes right now," says Meyer, "because if you have a little skill, you can buy timber today [and achieve] a 7.5%-8% annual real return, assuming flat log prices." He has three professional lumberjacks on the payroll who protect the forests he buys and help manage them.

Harvard's clout brings other advantages. It has achieved an eye-popping 17.7% annual return on private equity over the past five years. That's largely because it has access to some of the best private funds, including the fabled Kleiner Perkins, where it was the first institutional client. "Everybody would like to get into the Kleiner Perkins fund, but you can't get in [any longer]," says Meyer. Likewise, it has an entrée into the cream of hedge funds. It puts another 12% into those funds aiming to produce positive returns whether the stock market is up or down.

With his highly-paid pros—two of his fund managers each earned more than \$5 million last year—Meyer can execute sophisticated transactions way beyond the scope of individuals. But can private investors draw any lessons from what Harvard does?

Meyer says they can, but should be guided by four key principles. First, get diversified. Come up with a portfolio that looks a little like ours and covers a lot of asset classes." Second, you want to keep your fees low." That means avoiding the most hyped but expensive funds, in favor of low-cost index funds.

Unlike Harvard, which is tax-exempt, individuals must also pay close attention to the taxes on their investments. "That isn't often done in individual investing," says Meyer, "but it affects what your portfolio should look like and how much turnover you want." And finally, invest for the long term. You never know, with such an approach you too could join the ranks of the crimson. ■

er than placing all your bets on U.S. and bonds, diversify and seek professional help to put money in foreign commodities and the like.

long-term because you have a wider choice of investment options are not worried about selling assets in

Husbanding that \$27 Billion

Harvard's Jack Meyer doesn't see future returns matching past yields

Harvard Management CEO Jack R. Meyer makes outsize returns on the \$27 billion he invests for the university. Recently he gave a rare interview to William C. Symonds, *BusinessWeek's* Boston bureau chief. Here are excerpts:

You've had a great run. But recently you've been warning that you don't expect the good times to last. Why not?

Because when you look at the various asset classes in which we invest, they're all pretty expensive. The U.S. market is expensive by any valuation. The emerging markets were cheap for a while, but they have had a tremendous run over the past two years. In private equity, there is too much money chasing those deals, so they are less attractive than they were 10 years ago. It's hard to get excited about Treasury bonds yielding 5%.

What can you get excited about?

Timber. As an asset class, it is mispriced. If you are patient and have a little skill, you can buy timber today to return 7.5% to 8% a year in real terms, assuming flat real log prices.

You've got about 10% of your assets in timber. How do you buy it?

We have three professional lumberjacks on staff. They go and look at the trees. And this is the one asset class where our size is an advantage. There are very few people who show up in New Zealand and pay \$600 million in cash for a forest.

A lot of money is pouring into hedge funds. What do you make of that?

There are far fewer opportunities in the hedge-fund world than there were 2-to-

2½ years ago. There is too much money in there.

What does that mean for returns?

A lot of new funds have promised to give their investors double-digit returns. But I don't think [they'll deliver]. I suspect that thousands of hedge funds will eventually go out of business.

What kind of returns do you think you can still produce?

Our [benchmark] has returned 12% a year over the past decade. But in the next 10 years, 7% to 8% would be more like it.

How can individual investors find managers who can beat the Street?

Most people think they can find managers who can outperform, but most people are wrong. I will say that 85% to 90% of managers fail to match their [performance] benchmarks.

That's pretty pessimistic.

Yes. But because managers have fees and incur transaction costs, you know that in the aggregate they are deleting value. The investment business is a giant scam: It deletes billions of dollars every year in transaction costs and fees.

So what should individuals do?

Most people should simply have index funds so they can keep their fees low



MEYER Low profile

Crimson Success

Harvard aims for the following asset allocation over time:

U.S. EQUITIES	15%
COMMODITIES	13
PRIVATE EQUITY	13
HEDGE FUNDS	12
U.S. BONDS	11
FOREIGN EQUITIES	10
REAL ESTATE	10
INFLATION-INDEXED BONDS	6
EMERGING MARKETS	5
HIGH-YIELD	5
FOREIGN BONDS	5
BORROWED MONEY	-5

Data: Harvard Management Co

and their taxes down. No doubt about it.

What have been your biggest disappointments?

I was a fan of emerging-market equities early on, but I was wrong for a long time. And a lot of the trades we make each day are bad. But we try to structure them in such a way so that if things go wrong, we don't lose a great deal of money. And if they go right, we make a lot of money.

Critics argue that your managers are grossly overpaid. Your two top managers each earned \$25 million last year.

I'm confident our compensation system is sound. In fact, it's superior to any I've seen in the investment world. It's based on value added. So if you simply match the benchmark, you get no incentive bonus. Even if you were a commodities manager in fiscal 2000 and earned 59.6%, your bonus is zero, because that is what the benchmark was.

You could simply farm out your money the way other universities do.

Our fees would go up, our returns would go down, and we would likely underperform our peers because of our size. So I'm very confident that this has been a good deal for Harvard. What deserves serious debate is whether you can maintain world-class portfolio managers in an academic setting. ■■

Margins To Marvel At

Some companies have learned how to prosper in good times and bad. **BY JOSEPH WEBER**

W HAT IS THE SECRET OF TAKING fliers on untested companies? A smarter—and safer—way to go is to find outfits with healthy profit margins year in and year out. Such companies have shown they can make money in good times and bad—whether they have the latest technology or simply a lock on their industries or market niches that competitors can't touch.

You find such moneymakers in all sorts of businesses, from high tech to drugs. At *BusinessWeek's* request, Zacks Investment Research Inc. of Chicago ranked the top performers of the Standard & Poor's 500-stock index by their net operating margin—aftertax income, without unusual items, divided by sales. BW then culled the list to take out those that face humbling challenges, such as drugmaker Merck & Co., which is reeling from the Vioxx fallout and uncertainty about management succession. We also nixed companies that, on a margin basis, are difficult to compare to others, such as banks. We were particularly interested in finding those that have shown their margin power over the past five years, a boom-and-bust time that would test any management's skills.

The result is a group of All-Stars that, though rarely cheap, are proven winners (table). Though many are ful-

ly priced today, these high performers are likely to continue to be big gainers over time.

Look at Linear Technology Corp. It's a small player in the giant chip business, with less than \$1 billion in annual sales. But the 23-year-old Milpitas (Calif.) company churns out chips used in such hot areas as cell phones and notebook computers. Its products are so coveted that Linear Tech has averaged a better-than-40% net operating margin for the past five years, nearly twice that of its biggest rival, Intel Corp. "They make gob-

of money," says David Wu, semiconduc-

Profit Powerhouses

Companies with an ability to maintain their profit margins make good investments, especially in an era when many face higher costs and little pricing power. Some promising picks:

COMPANY/SYMBOL	NET OPERATING 2004*	PROFIT MARGIN 5-YR. AVERAGE**
AMBAC FINANCIAL ABK	50.0%	57.6%
LINEAR TECHNOLOGY LLTC	40.9	40.6
QUALCOMM QCOM	37.3	27.8
MICROSOFT MSFT	36.7	37.7
MOODY'S MCO	31.6	24.3
AMGEN AMGN	30.6	31.3
PFIZER PFE	30.4	25.9
FOREST LABORATORIES FRX	28.8	22.0
ORACLE ORCL	26.7	23.4
ADOBE SYSTEMS ADBE	26.4	21.9
EBAY EBAY	25.5	18.5
T. ROWE PRICE TROW	25.4	21.9

*Through Sept. 30 **Jan. 1, 2000-Sept. 30, 2004

Data: Zacks Investment Research



of \$45, such growth rates could spell a healthy gain for investors.

Adverse news—especially when it hits a whole sector—can be a positive for those seeking to invest in companies with profit power. Caught in the industrywide downturn from Merck's problems with Vioxx, Pfizer Inc. has lost about \$11 a share so far this year and now trades at just \$27. Pfizer markets a similar drug, Bextra, but the Food & Drug Administration has said it is satisfied that Bextra is safe when properly used. Pfizer sells a broad array of other products that nobody questions. So bulls on Pfizer insist the company's low valuation is ludicrous, especially given its impressive 30.4% operating margin. "Pfizer has continued to deliver," says Deutsche Bank Securities Inc. analyst Barbara A. Ryan. "The stock is exceptionally cheap."

Indeed, patient investors who stick with big-margin companies have seen healthy payoffs. Qualcomm Inc. has steadily climbed from below \$15 a share in early 2003 to around \$43 now. The company, thriving on shifts around the world to its CDMA type of cell-phone technology, has plenty of room to grow. Analysts at the National City Private Client Group, the wealth-management arm of the National City Corp. banking company, figure the stock is worth at least an additional \$5 a share—and they've been bullish on it for years. The group's research director, Mary Jane Matts, says Qualcomm's technology offers a "significant competitive advantage."

Of course, high valuations can test any investor's mettle. Shares of mutual-fund company T. Rowe Price Group have climbed from about \$48 to over \$60 a share this year. T. Rowe Price has sharply outperformed rivals, especially those tainted in market-timing and other scandals uncovered by New York Attorney General Eliot Spitzer and other investigators. In fact, some analysts think the \$1.3 billion-a-year company has become too pricey, even if assets under management grow by an expected 17% next year. Still, Friedman Billings Ramsey & Co. analyst Matthew J. Snow-

CAUTION: THE STOCKS OF HIGH-MARGIN OUTFITS USUALLY ARE NOT CHEAP

ing calls the company "among the most reliable," adding that it consistently turns in a "best-of-breed performance." That means there's still room for the fund company's shares to run.

HIGH-TECH STANDOUT

USUALLY, COMPANIES THAT deliver the best results for shareholders are those that offer customers something unique or dominate their markets. Retaining dominance is tough, and it requires spending big money. Case in point: Oracle Corp., the world leader in corporate database products, plans to spend \$10.3 billion to buy PeopleSoft, the No. 2 player in enterprise software. That will give Oracle, now No. 3 in enterprise software, more clout with its customers. "It was a long, protracted, and acrimonious battle," says S&P equity analyst Jonathan Rudy, referring to the 18 months Oracle spent trying to seal the deal. "It ended pretty well."

Wall Street, expecting Oracle to prevail, has bid up its stock from below \$10 a share in September to above \$14 now. Even so, says Rudy, there are more gains left as Oracle brings PeopleSoft into its fold.

Investors who opt for some high-margin producers may feel their patience tried because the stocks are already fully-priced. EBay Inc. has a net operating margin so far this year of more than 25%, well above its 18.6% five-year average. At about \$114 a share now, the online auctioneer's stock has more than doubled in the past year, and further big gains in price could be at least 18 months to two years away. "The investor who buys eBay has to be willing to hold for the long term," says CIBC World Markets analyst Paul Keung.

While there's power in enduring profitability, high-margin producers aren't immune to market downturns, and nasty surprises can throw them off course—and possibly into Wall Street's dog house. But for the most part, their solid track records show these companies are consistent performers with managers that know how to keep their engine humming. That's a sound investors love to hear. ■

or analyst for Wedbush Morgan Securities in Los Angeles. "That's the most special thing about them."

Demand should be brisk through 2005 for many of the customers Linear Tech serves. That's why Wu believes the company will show 19% hikes in both net earnings and sales—to \$390 million and \$663 million, respectively—for the fiscal year ending in June. With Linear Tech's stock about \$7 off its January, 2004, high

Making a Pile On Cash-Rich Companies

Many corporations are sitting on hoards of the folding stuff. You want to own the ones that'll use it wisely. **BY DEAN FOUST**

CALL IT CORPORATE America's version of the Strategic Petroleum Reserve. As companies have been racking up record earnings over the past few years, they've let cash pile up rather than plow it into new hiring and capital spending. Now they're sitting on a massive reservoir of untapped fuel. "There's going to be increasing pressure on companies to get rid of that cash and start paying it out in dividends," says Donald A. Yacktman, who manages two mutual funds.

For investors, some of the best opportunities to profit from this cash may lie in the drug sector. Yacktman's favorite pick there is Bristol-Myers Squibb Co. The bad karma hanging over pharmaceuticals has beaten down the stock. And its restatement of past earnings, after it settled charges in August that it had improperly booked \$1.5 billion in revenues, didn't help either. Yacktman believes Bristol-Myers has cleaned up its act—and is a compelling buy at just 17 times its estimated 2005 earnings. "It's still a very profitable drug company," he says. He also believes that Bristol-Myers' strength in cancer research is going to pay off if drugs that have completed many of their clinical trials—such as Ixabepilone, which shows promise in fighting prostate and metastatic breast cancer—come to market. Meantime, there's \$7.25 billion of cash sitting on the company's balance sheet, which Yacktman expects will be deployed soon, either to raise dividends or make an acquisition.

Sometimes the best play is a company in turnaround mode with a hefty cash hoard—promising not just rising payouts but also a boost in the stock price as earn-



ings start to pick up. One such outfit may be Cigna Corp., says John DeGulis, who runs the \$1.6 billion Sound Shore Fund, which invests in large-cap value stocks. The Philadelphia health insurer has suffered massive customer defections in recent years because of computer glitches that caused it to fall way behind in paying and adjudicating claims. Enrollment fell 16% in 2004, and is set to drop an additional 8% in 2005, notes DeGulis. But he thinks Cigna has finally solved the problems of integrating its myriad computer systems, and it should see its customer rolls begin to stabilize at some point in the coming year.

HEALTHY STASH

HELPING CIGNA THROUGH this rough patch has been its mountain of cash. The company has built up roughly \$2.92 billion, a stockpile that works out to nearly \$200 for every share currently trading around \$81. DeGulis expects Cigna to use the cash for either stock buybacks or a share hike in its dividend, now a mere 10¢ a share. And he estimates that Cigna will generate an additional \$600 million in free cash this coming year. "That's worth 20% of the market cap right there," he says.

Outside of health care, some of the biggest stashes are to be found in the technology sector, where companies can earn hefty margins without taking on much, if any, debt. Bartlett R. Geer, lead

**BRISTOL-MYERS'
\$7.25 BILLION MAY
SOON GO TOWARD
HIGHER DIVIDENDS
OR AN ACQUISITION**



ive gears to meet your expectations.
and a sixth to pass them.

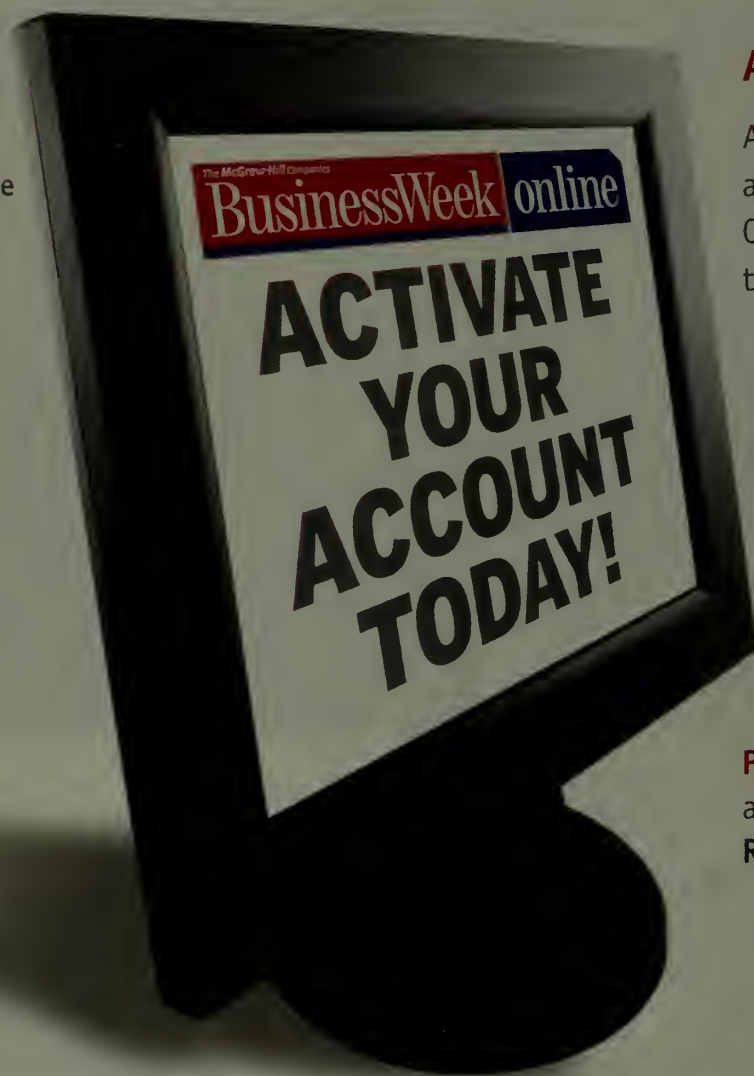
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anager of the \$3.47 billion dividend-
 -used Putnam Equity Income Fund,
 s Siebel Systems Inc. The San Mateo
 (lif.) maker of call-center and sales-
 e software fell out of favor on Wall
 et as it lost ground to rivals such as
 and salesforce.com. But some ana-
 s believe that new CEO J. Michael
 rie has brought a focus and rigor to
 company that was lacking under co-
 -nder Tom Siebel. And Geer notes that
 el, whose stock trades at around \$10,
 v boasts a nice cushion of \$4.24 per
 re in net cash on its balance sheet—
 ough to suggest that Siebel could be-
 -paying a dividend at some point.

YOU T BAIT?

B KICKER, HOWEVER, is that Geer be-
 -es Siebel could become a takeover tar-
 -perhaps for one of the larger software
 -ers. Indeed, evidence that Oracle
 p. submitted last summer in an an-

CIGNA'S STOCKPILE OF \$2.9 BILLION COULD HELP FINANCE A HEFTY STOCK BUYBACK

panies that are counting oodles of cash.
 Among smaller ones, James M. Tringas,
 manager of the \$2 billion Evergreen
 Special Values Fund, which invests in
 small-cap value stocks, likes Arkansas
 Best Corp., a transportation outfit that
 specializes in handling shipments that
 amount to less than a full truckload.
 With demand booming, Arkansas Best's
 profits have grown an average of 21% an-
 nually during the past five years. That
 has in turn boosted its cash to \$50
 million—or \$1.80 a share—and the
 company continues to
 generate more than
 that in free cash flow
 every year. Tringas
 estimates that within a
 couple of years,
 Arkansas Best will be
 holding the equivalent
 of \$10 a share in cash,
 which he believes the
 company will begin
 paying out in special
 dividends. "They'll be
 significantly overcapi-
 talized," he says. "And
 they're not likely to
 use all of that cash just to buy back
 stock."

The comeback of coal is boosting an-
 other small-cap outfit. Joy Global Inc., a
 Milwaukee maker of equipment for coal
 and copper mining ranging from roof
 supports to shuttle cars, currently has
 \$170 million in the kitty. Joy is benefiting
 from the increasing reliance of utilities on
 coal to fire their power plants.

And the company is getting a boost
 from a big customer: the growing Chi-
 nese coal industry, which could surpass
 the U.S. industry in five years. Tringas be-
 lieves that Joy will generate as much as
 \$500 million in free cash flow in the next
 several years, which could be used for ei-
 ther niche acquisitions or to beef up its
 current 45¢-a-share dividend, which rep-
 resents just a 1.1% yield. "They could
 raise the dividend significantly from
 where it is," says Tringas. That's certain-
 ly what investors who hunt out cash-rich
 companies like to hear. ■

the Green

COMPANY/ MBOL	PRICE*	CASH** (BILLIONS)	CASH PER SHARE
ALTRIA GROUP MO	\$59.14	\$6.67	\$3.25
ARKANSAS BEST ABFS	42.40	0.05	1.80
Bristol-Myers Squibb BMY	23.81	7.25	3.73
CIGNA CI	81.00	2.92	21.79
JOY GLOBAL JOYG	37.42	0.17	3.30
SIEBEL SYSTEMS SEBL	9.99	2.15	4.24

* As of 10/30/04 ** As of end of last quarter

Data: Bloomberg Financial Markets, Yahoo! Finance

ust trial revealed that Siebel was one of
 en software companies the giant has
 -sidered purchasing. "When Oracle
 s done with PeopleSoft Inc., you
 ould think they might take a look at
 el," Geer says.

Altria Group Inc., the tobacco giant for-
 -ly known as Philip Morris Cos.,
 ight also prove to be a tempting invest-
 -ment. Even with its current 5.1% dividend
 -out, Altria maintains a war chest of
 \$6.7 billion, or \$3.25 a share. For now,
 the company is keeping part of that cash
 -case it needs to pay bonds in pending
 -ongful-death class-action suits in
 -rida and Illinois and in a federal suit
 -ed by the Justice Dept. But Geer believes
 -t Altria could resolve some or all of this
 -igation during 2005—freeing it to pur-
 -e a spin-off move of its Kraft Div. as
 -ll as to boost its dividend. "At some
 -nt, some of that cash becomes usable,"
 -s Geer.

Of course, it isn't just the large com-

"WHERE
 DO THE
 GERMANS
 GO FOR
 CUTTING-EDGE
 AUTOMOBILE
 TECHNOLOGY?"

Heinrich
 von Pierer
 of Siemens
 explains that
 engineering
 and innovation
 are alive and
 well and living
 in France.

Protecting Yourself From a Housing Slump

Even if fears of a bubble are overblown, it's a good time to start thinking defensively. **BY PETER COY**



IN MANY U.S. CITIES, THE housing market looks as extravagant and top-heavy as a Dr. Seuss castle. In metro New York, the median price of a single-family house is up 78% since 1999, according to the Office of Federal Housing Enterprise Oversight. The gains are even bigger in Miami (87%), Los Angeles (97%), and San Diego (115%). For years house prices in these markets have risen faster than family incomes. The trend made sense when mortgage interest rates were falling, but rates hit bottom in mid-2000 and they're likely to rise. Put it all together, says Yale University economist Robert J. Shiller and "it seems like house prices are within a year or so of a cyclical peak."

Even if the worries of a nationwide housing bubble are overblown, it's prudent for people living in the hottest markets to prepare for the possibility that prices will flatten out or fall in 2005.

So, what should you do? In a nutshell: Pull in your horns by paying off debt and reining in spending. Also, think defensively about the housing market. It's fine to take financial risks when you know you can raise cash quickly by selling your house for a big profit or taking out a home-equity loan. But you need to behave differently if there's a chance that you won't be able to sell or borrow against your house on reasonable terms.

Preparing for a downturn is a bit like boarding up your windows ahead of a hurricane that never strikes, if you're lucky. Here's what experts advise:

- Make sure you can cover your mortgage payments and other unavoidable expenses for six months even if the main breadwinner is laid off. That will save you from having to sell your house to raise cash in a down market, says Lawrence J. Kotlikoff, a Boston University

Siemens' President and CEO, Heinrich von Pierer, says the French set a benchmark for innovation.

What makes France different?

Unlike other countries which have staked their future on services, France has maintained its manufacturing base. French companies like Total, AREVA, Renault, PSA Peugeot Citroën and many others are world leaders in their fields. I think this is enormously important. If you give up your manufacturing base, sooner or later you have to give up your engineering and R&D bases as well. And engineering and innovation are the cornerstones of our business.

What else makes France so attractive to you as an investor?

You have to go where your customers are. When you're a supplier in the car industry, your customers often ask, "Why aren't you closer to me?" They often say, "Come a little bit closer". We're particularly strong in the automobile industry and that's a sector in which France has two major global players: PSA Peugeot Citroën and Renault. Always good customers of ours. Now we're closer than ever.

Siemens has three R&D centers in France. How come?

The French are very open to innovation. Again, look at the car industry. Right now, the number of electronic components in cars is growing by about 30 percent. As an electronics company, a lot of our new developments are being made in France. We've developed a new diesel injector based on piezo-electric technology and PSA Peugeot Citroën has turned out to be our leading customer for it. When we moved into the automotive sector in France in 1988, we had sales of €130 million. Today, they're up to €1.4 billion. That's a good number.

Siemens in France

- Established in France since 1850
- 11,000 employees with 1,500 dedicated to R&D
- France is at the heart of Siemens' European operations in the automotive and public transport sectors

you have well-trained, highly motivated people. Productivity in Toulouse is among the highest of all our automotive factories.

Do you enjoy doing business in France?

I love it. From a cultural perspective, France is unique. It's not just the wine and cheese. I was driving through

The French are innovative. Are they good to work with?

Our industry demands a high degree of automation. And with automation increased productivity is only possible with very well-educated people. In France



"Unlike other countries... France has maintained its manufacturing base. Companies like Total, AREVA, Renault, PSA Peugeot Citroën... are world leaders in their fields."

Paris this afternoon, thinking: "What a great city, even on a grey day like today". There's a German proverb - "Leben wie Gott in Frankreich" - which translates as "Living like God in France". That says it all!

You're German. Would you drive a French car?

Sure. We used to have a Renault.

Were you happy with it?

Absolutely. My wife adored it. The French know how to appeal to the emotions. Result: my wife was happy, so I was happy.

(This interview was conducted in October 2004)

For more information on investing in France, visit www.thenewfrance.com

economist. One way to increase your flexibility is in arrange for the biggest possible home equity line of credit now—while your house value is still high and banks are still accommodating. But don't actually use the line. It's there to be tapped in an emergency.

■ Save more and borrow less. Americans' personal savings rate has dropped to just 0.2% of disposable income, a near-record low. Many people feel they don't need to save money because zooming house prices are doing their saving for them. But much of that paper wealth could be blown away if house prices fall. So people need to save the old-fashioned way—by not spending. And don't borrow against your house to invest in stocks. If the stocks tumble, you will still have to pay back the loans. By reducing debt now, you can avert having to sell your house at a loss if your cash flow dries up.

■ Treat the housing market as a risk, not an opportunity. If you're thinking of selling when prices have already soared, don't hold off in hopes that prices will soon go even higher. List your home this coming March or April, as soon as house-hunting weather improves, suggests Julie Garton-Good, an author and expert on residential real estate. Should you also delay a purchase hoping that the price will fall? That's a tougher call. It's no fun to be stuck in limbo waiting for a crash. But there's certainly no rush to buy now. Garton-Good thinks there will be many motivated sellers cutting prices by next fall.

■ Get ready to ride out a downturn. If you were planning to move next year, keep your options open in case the market softens and you no longer want to sell. As long as you can sit tight until prices bounce back, you can afford to ignore a decline in the market value of your house. Says Yale University economist William N. Goetzmann: "The paper loss is not going to affect your life too much" because you're not losing actual cash.

In a perfect world, people would be able to insure themselves against falling house prices. Yale's Shiller has long advocated the creation of futures and options linked to indexes of house prices in specific markets. Using those instruments as hedges, insurers could offer policies that would then pay off if prices in a policyholder's neighborhood fell. On Dec. 3 the Chicago Mer-

The Price of Luxury

The *BusinessWeek* Luxury Housing Affordability Index shows huge differences between cities. The higher the index, the more affordable the market.

HOW WE CREATED THE INDEX

The usual affordability index tells whether a mid-market house is within the budget of a middle-income family. *BusinessWeek's* index, based on house-price data from Fidelity National Financial Inc., looks at the top 10% of house prices and incomes. An index value of 100 means that given prevailing mortgage rates, a family earning just enough to be in the top 10% of incomes in a metro area should be able to afford a house that is just in the top 10% of prices.

CITIES	LUXURY HOUSE PRICES*	AFFORDABILITY INDEX
Atlanta	\$300	212
Boston	815	103
Chicago	504	136
Detroit	332	195
Los Angeles	870	72
New York	750	91
Philadelphia	400	172
Phoenix	395	151
San Diego	890	76
San Francisco	1,342	79
Washington, D.C.	760	109

*Third quarter 2004, in thousands of dollars

Data: Fidelity National Financial Inc. Housing & Urban Development Dept

cantile Exchange agreed with Macro Securities Research, where Shiller is chief economist, to look into creating house-price futures. But that's a long-term fix.

ROOM TO RISE

IN THE SHORT TERM, *BusinessWeek's* Luxury Housing Affordability Index shows cause for concern about prices, especially in hot coastal markets (table). The index tracks whether upper-bracket houses are affordable to people with upper-bracket incomes, analogous to the National Association of Realtors' index for median-priced houses. Among major metro areas, the index shows, high-end housing is the least affordable in Los Angeles, followed by San Diego. In contrast, up-market properties consume a smaller share of income in Atlanta and Detroit.

The recent sharp boom in prices has caused many people to forget that in normal times, housing is a slow-growth in-

vestment. From March, 1975, through the end of 1999, OFHEO's single-family house price index rose 268%—just a shadow of the 1,663% increase in the Standard & Poor's 500-stock index. In the short time since then, the house price index has jumped 47%, even as the S&P fell 24%. That suggests people who once speculated on stocks have turned to real estate.

Sure, there are plenty of cities where prices are reasonable and could continue to climb. David Lereah, chief economist of the National Association of Realtors, recently finished a book, due out in February, called *Are You Missing the Real Estate Boom?* He predicts that strong growth will boost incomes, mortgage rates will stay reasonable, immigration will feed housing demand, zoning laws will restrict construction, and demand for housing from baby boomers and their children, the echo generation, will remain strong. Says Lereah: "I foresee a healthy expansion."

Still, a lot of homeowners and potential buyers in super-hot markets worry that 2005 could be the year that the housing bubble finally pops. The best insurance against that is old-fashioned financial conservatism. If you keep your leverage modest and prepare yourself to sit tight, even a steep drop in prices should be manageable. ■

Bad-Weather Checklist

BUILD UP A RAINY-DAY FUND so you won't have to sell in case you lose your job

AVOID HOME-EQUITY LOANS that could leave you with more debt than your house is worth

IF YOU'RE IN THE MARKET, accelerate plans to sell or delay plans to buy, where possible

BE PREPARED TO STAY where you are for a few extra years until the market recovers

Data: *BusinessWeek*



FOOD AND FAMILY. The 2 sources of cholesterol.



VYTORIN

treats them both.

You probably know that cholesterol comes from food. But what you might not know is that your cholesterol has a lot to do with your family history.

Now there's VYTORIN. When diet and exercise aren't enough, adding VYTORIN can help.

VYTORIN helps block the absorption of cholesterol that comes from food *and* reduces the cholesterol that your body makes naturally. And VYTORIN can dramatically lower your bad cholesterol 45%–60%.

(Average effect depending on dose. 52% at the usual starting dose.)

Ask your doctor about **NEW VYTORIN**.

Important information: VYTORIN is a prescription tablet and isn't right for everyone, including women who are nursing or pregnant or who may become pregnant, and anyone with liver problems. Unexplained muscle pain or weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. VYTORIN may interact with other medicines or certain foods, increasing your risk of getting this serious side effect. So, tell your doctor about any other medications you are taking.

To learn more, call
1-877-VYTORIN or visit vytorin.com

Please read the Patient Product
Information on the adjacent page.

NEW
VYTORIN[™]
(ezetimibe/simvastatin)

Treat the 2 sources of cholesterol.



MERCK / Schering-Plough Pharmaceuticals

To find out if you qualify call 1-800-347-7503

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Patient Information about VYTORIN (VI-tor-in)

Generic name: ezetimibe/simvastatin tablets

Read this information carefully before you start taking VYTORIN. Review this information each time you refill your prescription for VYTORIN as there may be new information. This information does not take the place of talking with your doctor about your medical condition or your treatment. If you have any questions about VYTORIN, ask your doctor. Only your doctor can determine if VYTORIN is right for you.

What is VYTORIN?

VYTORIN is a medicine used to lower levels of total cholesterol, LDL (bad) cholesterol, and fatty substances called triglycerides in the blood. In addition, VYTORIN raises levels of HDL (good) cholesterol. It is used for patients who cannot control their cholesterol levels by diet alone. You should stay on a cholesterol-lowering diet while taking this medicine.

VYTORIN works to reduce your cholesterol in two ways. It reduces the cholesterol absorbed in your digestive tract, as well as the cholesterol your body makes by itself. VYTORIN does not help you lose weight.

Who should not take VYTORIN?

Do not take VYTORIN:

- If you are allergic to ezetimibe or simvastatin, the active ingredients in VYTORIN, or to the inactive ingredients. For a list of inactive ingredients, see the "Inactive ingredients" section at the end of this information sheet.
- If you have active liver disease or repeated blood tests indicating possible liver problems.
- If you are pregnant, or think you may be pregnant, or planning to become pregnant or breast-feeding.

VYTORIN is not recommended for use in children under 10 years of age.

What should I tell my doctor before and while taking VYTORIN?

Tell your doctor right away if you experience unexplained muscle pain, tenderness, or weakness. This is because on rare occasions, muscle problems can be serious, including muscle breakdown resulting in kidney damage.

The risk of muscle breakdown is greater at higher doses of VYTORIN.

The risk of muscle breakdown is greater in patients with kidney problems.

Taking VYTORIN with certain substances can increase the risk of muscle problems. It is particularly important to tell your doctor if you are taking any of the following:

- cyclosporine

- antifungal agents (such as itraconazole or ketoconazole)
- fibric acid derivatives (such as gemfibrozil, bezafibrate, or fenofibrate)
- the antibiotics erythromycin and clarithromycin
- HIV protease inhibitors (such as indinavir, nelfinavir, ritonavir, and saquinavir)
- the antidepressant nefazodone
- amiodarone (a drug used to treat an irregular heartbeat)
- verapamil (a drug used to treat high blood pressure, chest pain associated with heart disease, or other heart conditions)
- large doses (≥ 1 g/day) of niacin or nicotinic acid
- large quantities of grapefruit juice (>1 quart daily)

It is also important to tell your doctor if you are taking coumarin anticoagulants (drugs that prevent blood clots, such as warfarin).

Tell your doctor about any prescription and nonprescription medicines you are taking or plan to take, including natural or herbal remedies.

Tell your doctor about all your medical conditions including allergies.

Tell your doctor if you:

- drink substantial quantities of alcohol or ever had liver problems. VYTORIN may not be right for you.
- are pregnant or plan to become pregnant. Do not use VYTORIN if you are pregnant, trying to become pregnant or suspect that you are pregnant. If you become pregnant while taking VYTORIN, stop taking it and contact your doctor immediately.
- are breast-feeding. Do not use VYTORIN if you are breast-feeding.

Tell other doctors prescribing a new medication that you are taking VYTORIN.

How should I take VYTORIN?

- Take VYTORIN once a day, in the evening, with or without food.
- Try to take VYTORIN as prescribed. If you miss a dose, do not take an extra dose. Just resume your usual schedule.
- Continue to follow a cholesterol-lowering diet while taking VYTORIN. Ask your doctor if you need diet information.
- Keep taking VYTORIN unless your doctor tells you to stop. If you stop taking VYTORIN, your cholesterol may rise again.

What should I do in case of an overdose?

Contact your doctor immediately.

What are the possible side effects of VYTORIN?

See your doctor regularly to check your cholesterol level and to check for side effects. Your doctor may do blood tests to check your liver before you start taking VYTORIN and during treatment.

In clinical studies patients reported the following common side effects while taking VYTORIN: headache and muscle pain (see What should I tell my doctor before and while taking VYTORIN?).

The following side effects have been reported in general use with either ezetimibe or simvastatin tablets (tablets that contain the active ingredients of VYTORIN):

- allergic reactions including swelling of the face, lips, tongue, and/or throat that may cause difficulty in breathing or swallowing (which may require treatment right away), and rash; inflammation of the pancreas; nausea; gallstones; inflammation of the gallbladder.

Tell your doctor if you are having these or any other medical problems while on VYTORIN. This is not a complete list of side effects. For a complete list, ask your doctor or pharmacist.

General Information about VYTORIN

Medicines are sometimes prescribed for conditions that are not mentioned in patient information leaflets. Do not use VYTORIN for a condition for which it was not prescribed. Do not give VYTORIN to other people, even if they have the same condition you have. It may harm them.

This summarizes the most important information about VYTORIN. If you would like more information, talk with your doctor. You can ask your pharmacist or doctor for information about VYTORIN that is written for health professionals. For additional information, visit the following web site: vytorin.com.

Inactive ingredients:

Butylated hydroxyanisole NF, citric acid monohydrate USP, croscarmellose sodium NF, hydroxypropyl methylcellulose USP, lactose monohydrate NF, magnesium stearate NF, microcrystalline cellulose NF, and propyl gallate NF.

Issued July 2004

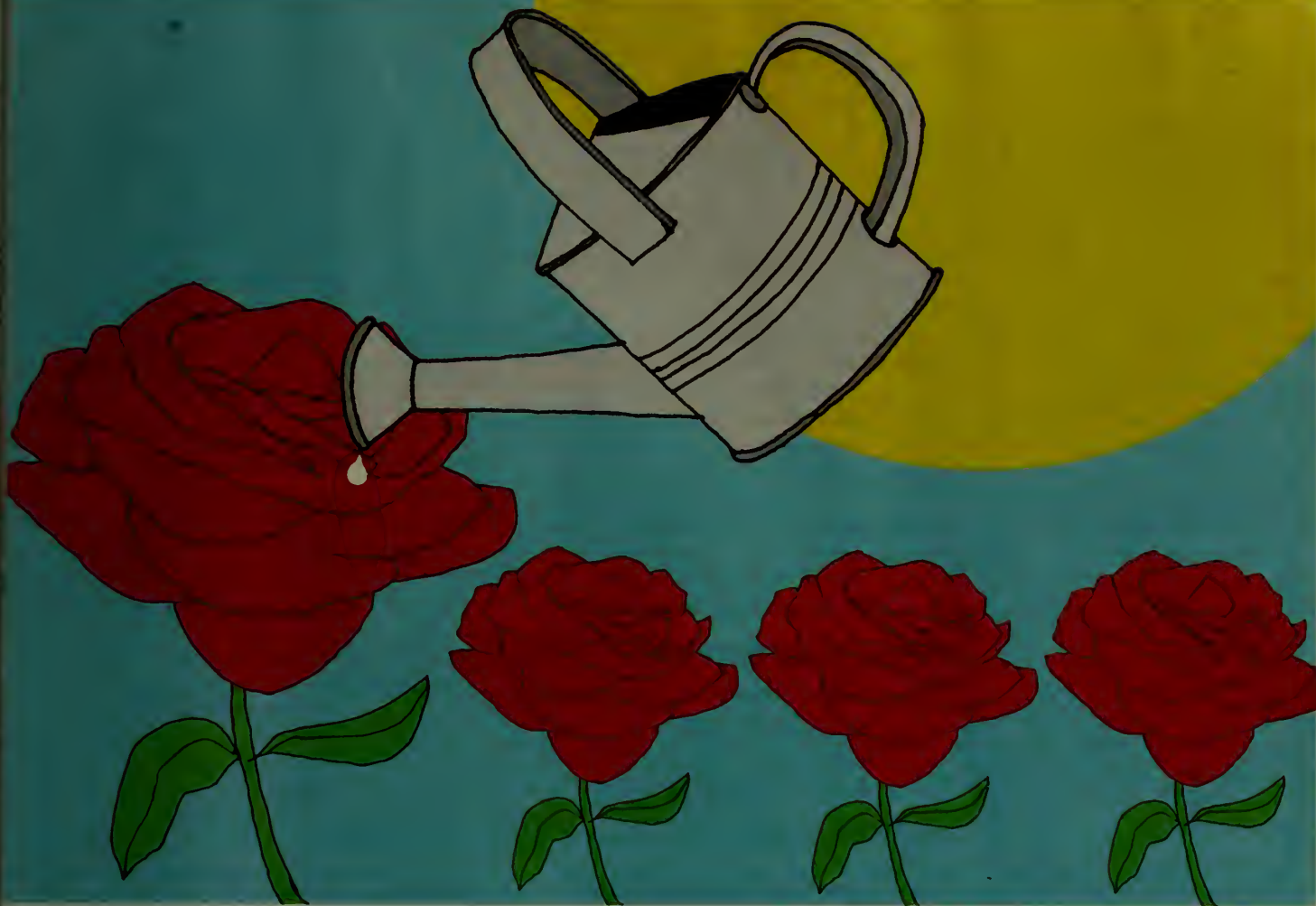


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How to Get More For Your Money

Interest rates are up, but not much. A little risk will boost yields. **BY TODDI GUTNER**

EARNING 5% ON YOUR money may sound pretty lame, but hey, in this interest-rate environment, when bank CDs pay a couple of percentage points, plenty of folks would jump at it.

Reaching for higher yields does mean taking on some more risk. The big one is that higher rates will depress the value of your investment. But if you're happy with the return and you plan to hold on until maturity, say with a municipal bond, then market fluctuations shouldn't

discourage you from making the deal.

Still, you have to be picky about choosing these income-oriented investments. We found the best opportunities in municipal bonds, closed-end bond funds, international bonds, and in a lesser-known corner of the market, master limited partnerships and income trusts.

» MUNICIPAL BONDS

THE SWEET SPOT in munis is in the high-yield sector. An improving economy lifts credit ratings in general, and that includes lower-quality bonds, says Mary

J. Miller, fixed-income director at T. Rowe Price Associates. Bonds rated B and BB yield 6% and 5.1%.

But you don't need to go that far down the credit scale to make some money. The current 4.2% yield on a 10-year, BBB-rated muni bond is the equivalent of a 6.5% taxable yield, assuming a 35% federal and state tax rate. If you want nothing but the top tier, the tax-equivalent yields are not bad. The 3.5% you can earn on a 10-year, AAA-rated bond is the equivalent of a 5.4% taxable yield, assuming a 35% bracket.

Sure, a long-term muni is risky in a rising interest-rate environment. But munis are less volatile in price than Treasuries because the market is dominated by individuals who buy and hold rather than institutional investors who trade them often. If you don't need to dump the bond in a hurry, the price volatility should not be a problem.

» CLOSED-END BOND FUNDS

YOU CAN GET yields of more than 6% in closed-end bond funds. Unlike mutual funds, closed-ends have a fixed number of shares that trade on a stock exchange. Depending on demand, closed-ends trade at a price higher or lower than their net as-

set value (NAV), what the fund's bonds are worth

As a rule, you only want to buy funds when they sell at a discount to NAV. Discounts for the Van Kampen Income Trust and Oppenheimer Multi-Sector Income Trust are both 12%, resulting in yields of 5.7% and 5.3% respectively. "Those discounts get very wide at the end of the year because of investors taking tax losses on some of their investments," says Thomas J. Herzfeld, whose Miami firm specializes in closed-end funds.

These discounts help boost the returns. Suppose a fund has bonds that pay 5.5%. The fund has an NAV of \$10 a share, and it happens to be trading at \$10. Then the yield will be 5.5%. But if the fund's shares drop to a 10% discount, or \$9, the yield jumps to 6.1%.

Not any fund with a discount will do. The majority of closed-end bond funds are leveraged, which means they borrow money to buy even more bonds. That's not a good strategy when rates are moving up, since the value of the bonds is likely to fall. Unleveraged funds can get hit by rising rates, but not as badly as those that have borrowed to the hilt.

» INTERNATIONAL BONDS

YOU CAN LOOK abroad to enhance your portfolio income. In many countries, yields are high enough on their own to beat what's available here. Polish zloty bonds pay 6.1%, Mexican peso bonds are 10%.

Of course, finding an individual zloty bond is no easy task. That's why many investors turn to international bond funds for diversification and convenience. These funds come in three flavors: Some hedge their currency exposure, which means you just make money from the interest on the bonds, not on the changes in currencies. Other funds never hedge, leaving the returns exposed to the ups and downs of the foreign exchange market. Right now, those are attractive because the dollar is weak. The third sort allows portfolio managers to hedge for when they think it will boost their funds' returns.

That's the strategy at Credit Suisse Global Fixed Income Fund, which has a 12-month

MLPs AND INCOME TRUSTS OFFER BETTER YIELDS THAN 10-YEAR TREASURIES

yield of 10.6%. Credit Suisse also limits currency fluctuations by requiring that at least 65% of its assets be in U.S. dollar-denominated debt. That's not hard to do, since many foreign issuers sell dollar-denominated bonds.

Emerging-market debt is especially attractive these days because the countries are often rich in commodities for which prices are high. Federated International High Income A and Alliance-

Bernstein Emerging Market Debt A, for example, are finding opportunities in Russia and Brazil. Ten-year Russian U.S.-dollar-denominated debt yield 6.6%, and 10-year Brazilian U.S.-dollar-denominated debt yields 8.1%, vs. 4.2% for comparable U.S. Treasuries. What's more, Russian bonds are hot. Two rating agencies already consider them investment grade, and a third is expected to soon follow suit. That's a hat trick that should create more demand—and higher prices—for the bonds.

» MASTER LIMITED PARTNERSHIPS/INCOME TRUSTS

MASTER LIMITED partnerships (MLPs) and income (or royalty) trusts can offer investors yields up to 10 percentage points over 10-year U.S. Treasuries. MLPs and income trusts, which are mainly in the energy sector, are required to pay out most or all of their cash flow in distributions. Neither pays income tax, so there's no problem with double taxation of dividends. Investors do typically pay their regular income-tax rate—not the 15% rate on dividends—on up to 20% of the cash distributions. Taxes on the remaining 80% or so are usually deferred until the investor sells the partnership or trust units. Then the proceeds are taxed at the 15% capital-gains rate.

The median yield for Wachovia Securities' MLP Composite, comprised of 30 energy companies, is 6.4%. Yves C. Siegel, of Wachovia, recommends Magellan Midstream Partners LP and MarkWest Energy Partners LP, which yield 6.2% and 6.6% respectively.

The highest yields can be found in Canadian income trusts. For example, Pengrowth Energy Trust has a current yield of 12.2% and Vermilion Energy Trust 12.8%. Most of the trusts pay out in Canadian dollars, which can provide an added boost if the greenback continues to decline.

While a rise in interest rates hurts most income investments, these vehicles can offset some of that decline by raising their distributions, says Siegel. That's dependent, of course, on energy prices remaining strong. A huge drop in the price of oil or gas will crimp the MLPs' and trusts' ability to pump cash. ■

Hunting for Higher Income

In a low-interest environment, you need to look beyond the basic government bonds to pick up any extra yields. Here are a few ways:

Municipal Bonds		
RATING	BOND	YIELD
AA+	OHIO GENERAL OBLIGATION 5% 2015	3.49%
AA-	MISSISSIPPI (G.O.) 5 3/4% 2014	3.63
BBB	N. CAROLINA EASTERN MUNI POWER 5 1/4% 2014	4.08
BB	NEZ PERCE, IDAHO POLLUTION CONTROL 7% 2014	5.48
Closed-End Bond Fund		
FUND/SYMBOL		YIELD
1838 BOND-DEBENTURE TRADING BDF		6.8%
VAN KAMPEN INCOME VIN		5.7
OPPENHEIMER MULTI-SECTOR INCOME OMS		5.3
MFS GOVERNMENT INCOME TRUST		4.9
International Bond Funds		
FUND/SYMBOL		YIELD
DRYDEN GLOBAL TOTAL RETURN A GTRAX		11.9%
CREDIT SUISSE GLOBAL FIXED-INCOME COM. CGFIX		10.6
FEDERATED INTL. HIGH INCOME A IHIAH		8.5
ALLIANCEBERNSTEIN EMERGING MKT. DEBT A AGDAX		7.2
Master Limited Partnerships and Trusts		
PARTNERSHIPS OR TRUSTS/SYMBOL		YIELD
VERMILION ENERGY TRUST† VET_UNTO		12.8%
PENGROWTH ENERGY TRUST PGH		12.2
MARKWEST ENERGY PARTNERS MWE		6.6
MAGELLAN MIDSTREAM PARTNERS MMP		6.2

Municipal bonds, closed-end bond funds, and MLPs closing price as of Dec. 10

International bond funds closing price as of Nov. 30

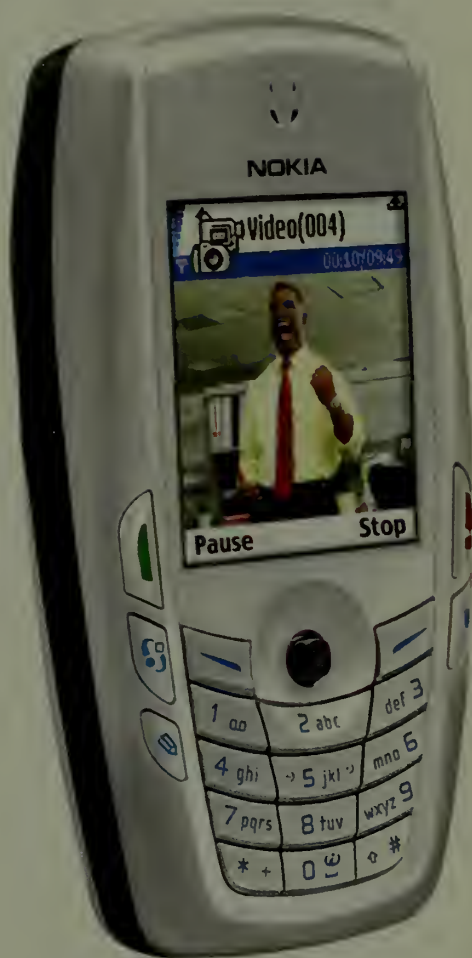
†Trades in Canadian dollars on the Toronto Stock Exchange

Data: T. Rowe Price, Thomas J. Herzfeld Advisors, Morningstar, Wachovia Securities



Shot at 2:34

Shared at 2:35



Your life with instant replay. **Shared instantly.**



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A man with a joyful expression, laughing with his mouth open and eyes closed, has his right arm raised with fingers spread. He is wearing a dark sweater over a collared shirt. The background is a clear, bright blue sky.

Financial advisors never grow tired of answering:

“What does S&P think?”

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Squeeze Your Portfolio Harder

You can bring in extra dollars by selling options on your stocks. **BY SUZANNE WOOLLEY**

THOSE OF US ON A QUEST for extra income may find it in an unexpected place—our portfolios of stocks. Since it's not likely that many stocks will rack up double-digit returns in the year ahead, taking advantage of a simple options strategy to wring more return out of our portfolios makes a lot of sense.

The way to get this extra return is by selling covered call options on your stocks or exchange-traded funds. When you sell, or "write" in options lingo, one of these contracts you give someone the right, but not the obligation, to buy shares from you at a set price for a specific period of time. As long as you're comfortable with all possible outcomes, including having to sell your stock to an option holder, you can get extra return from a trade you were willing to make anyway. If an option doesn't get exercised, you keep your stock and the amount you were paid for writing the option—called the premium. Sure, premiums may seem small—for example, \$1 per share for selling a 60-day covered call at \$55 on a \$52 stock. But that \$1 is about 2% of \$52, and if the option expires worthless, you've made 2% over 60 days. When annualized, that's a 12% return.

The trade-off: If the stock jumps and the option holder chooses to exercise, you will miss gains above \$55. If the stock gets to \$65, you still get only \$55. "Covered-call writers need a 'what if?' plan in place when they initiate a trade," says Jim Bittman, senior instructor at the Chicago



Board Options Exchange's Options Institute.

Here's how the strategy works. Let's assume your outlook for a stock is neutral or mildly bullish. If you're willing to sell a stock when it reaches your target price, you can write an "out-of-the-money" option. Say you think Coca-Cola (table), which trades at \$40.53, could hit \$42.50

sometime before May, and you would be happy to get that price. You can sell a call option with a \$42.50 "strike price" and, by May 2005, expiration and collect a premium of \$1.05 per share, or \$105 for a 100 share contract. That's a 3.3% return if the option isn't exercised. If it is, the return is 8.3%. That includes a \$1.97 profit per share on the stock if you bought it at \$40.53. "In effect, you've put in a limit order [an order to sell a stock at a preset price] and been paid for doing it," says Todd Salamone, vice-president for research at Schaeffer's Investment Research.

PLOTTING STRATEGY

IF YOU THINK A stock will tread water, you might write an "at-the-money" option. The price at which you'd sell is the current market price. Buyers are betting that the stock will go up and that they'll be able to buy it from you at a below-market price. You can also sell "in-the-money" calls, giving someone the right to buy, say, your \$22 stock at \$20 if it dips to that level. That puts a floor on the stock, and you'll be paid more for writing such a call. But recent tax changes have limited the appeal of in-the-money calls, so move carefully.

When plotting your options strategy, remember to factor in commissions, which vary widely between brokers. If you're writing less than 30 contracts, Charles Schwab Corp. charges a fee of \$29.95 for the first contract and \$2 for each additional one if you trade over the phone or online. A deep-discount broker such as optionsXpress charges \$1.50 per contract with a \$14.95 minimum per trade.

You may want to start out writing covered calls using a full-service broker, and then, when you get the hang of it, switch to a discount broker to save money on commissions. First though, check out the options education courses online. You

can take free online tutorials, and fee-based interactive seminars, at the Chicago Board Options Exchange's Options Institute (www.cboe.com), and click on "Learning Center." Another source to check for online tutorials and seminars in your area is the Options Industry Council (www.888options.com). The time and energy that you invest in educating yourself will help ensure that exploring your options is as profitable as possible. ■

Getting a Premium

You can generate some extra cash from your portfolio if you sell call options. Here are some sample option plays that show potential returns:

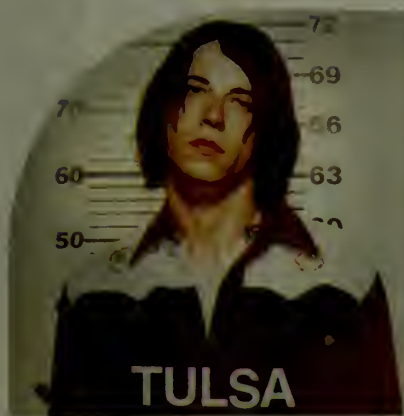
SECURITY/SYMBOL	PRICE*	OPTION EXPIRATION (2005)	STRIKE PRICE	OPTION PREMIUM*	EXPECTED RETURN**
Altria Group/MO	\$59.09	March	\$65.00	\$0.95	4.1%
Coca-Cola/KO	40.53	May	42.50	1.05	3.3
eBay/EBAY	114.41	April	115.00	8.90	8.4
Europe 2001/EKH	64.00	March	90.00	3.40	5.8
Nucor/NUE	49.99	April	52.50	4.20	9.7

*Prices and option premiums as of Dec. 13. **Potential return on 100 shares.
**Annualized return on unexercised options. Does not include commissions.

Data: Oppenheimer & Co.

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This Year Growth May Be the Way to Go

Value stocks have gotten pricey, and growth stocks, if not cheap, are more reasonably priced than they've been in years. **BY LEWIS BRAHA**

SOME MIGHT CONSIDER Bill Nygren a turncoat. The manager of Oakmark Fund is known to be a cautious value investor who buys the stocks of down-trodden, sometimes obscure companies. So why is his fund full of brand names—Wal-Mart Stores, McDonald's, Citigroup? "Today, you don't have to pay as much for growth or earnings consistency as you normally do," Nygren says. "So we're trading up."

Mutual-fund investors should take heed. Nygren and other top value managers believe that after four years in which cheap industrial, energy, small-bank, and real estate stocks have soared, the tide may be turning. Value stocks have grown expensive, and growth companies, if not cheap, are more reasonably priced than they've been in years.

You could hardly tell that from this year's top-performing funds. Across the board, value funds beat growth, and small-cap funds beat large-caps. Small-cap value funds, up 15.67%, did the best among domestic equity funds, which gained 9.05%. That's a slight improvement on the 8.52% total return earned by the Standard & Poor's 500-stock index. (All returns are as of Dec. 10.) "Both value stocks and small-cap stocks have run so hard for so long that they are no longer investment opportunities," says Ben Inker, director of asset allocation at Grantham, Mayo Van

Otterloo & Co., a Boston investment firm.

Growth-fund managers such as Bill D'Alonzo of Brandywine Blue Fund agree that their universe of stocks are relatively cheap. But D'Alonzo won't invest in just any old blue chip. "It makes more sense to us to find a company that has a new catalyst for earnings growth than gamble on a well-known, mostly mature one that has fallen on hard times," he says. He's

finding such catalysts at McDonald Corp., which is now offering appetizers for adults and apples and milk alternatives to french fries and sodas for kids. D'Alonzo's Brandywine has outperformed this year, gaining 14.32%, compared with just 5.46% for the average large-cap growth fund.

Outside of blue chips, investors are finding some buys in popular

The Best Equity Funds

FUND	TOTAL RETURN*	FUND	TOTAL RET
ProFunds Wireless Ultrasector Inv.	63.80%	T. Rowe Price Real Estate	34.3%
iShares MSCI Austria Index	60.04	Van Kampen Real Estate Securities A	34.0%
Bruce	49.01	Fidelity Select Natural Gas	33.8%
Fidelity Select Medical Delivery	41.76	Security Capital U.S. Real Estate S	33.6%
Fidelity Select Wireless	41.56	iShares MSCI South Africa Index	33.54%
State Street Research Global Resources S	40.60	ICON Energy	33.51%
ProFunds Real Estate Ultrasector Inv.	40.31	iShares Cohen & Steers Realty Majors	33.50%
ProFunds Energy Ultrasector Inv.	40.29	American Heritage	33.33%
Morgan Stanley Instl. Euro. Real Estate A	39.99	AIM Real Estate Inv.	33.25%
PIMCO Real Estate Real Return Strategy I	39.24	Oppenheimer Real Estate Y	33.14%
Vontobel Eastern European Equity	39.17	UMB Scout Energy	33.09%
Baron Partners	38.88	AllianceBernstein Real Estate Invst. Adv.	32.99%
iShares MSCI Belgium Index	38.80	Alpine U.S. Real Estate Equity Y	32.88%
U.S. Global Accolade Eastern European	37.98	Pioneer Real Estate Shares A	32.80%
iShares MSCI Mexico Index	37.40	Heitman REIT PBHG	32.69%
AIM European Small Company A	37.01	ELL Realty Securities Instl.	32.49%
Cohen & Steers Realty Focus Instl.	36.94	AEW Real Estate Y	31.95%
Strategic Partners Real Estate Secs. A	36.80	AIM Energy Inv.	31.71%
Cohen & Steers Realty Shares	35.85	Fidelity Real Estate Investment	31.44%
Morgan Stanley Real Estate D	35.24%	Vanguard Energy Admiral	31.36%

*Appreciation plus reinvestment of dividends and capital gains before taxes, Dec. 31, 2003-Dec. 10, 2004. Data: Standard & Poor's



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Smart Strategies Mutual Funds

The Worst Equity Funds

FUND	TOTAL RETURN*	FUND	TOTAL RETURN*
ProFunds Semiconductor Ultrasector Inv.	-37.35%	OCM Gold	-15.45%
Ameritor Investment	-35.29	Fidelity Advisor Electronics A	-15.16
Thurlow Growth	-34.76	Rydex Precious Metals	-15.06
Rydex Dynamic Venture 100 H	-23.13	ProFunds Short Small Cap Inv.	-14.54
ProFunds UltraShort OTC Inv.	-22.90	Prudent Bear	-14.45
Rydex Electronics Inv.	-22.86	Van Wagoner Growth Opportunity	-14.43
ProFunds Pharmaceuticals Ultrasector Inv.	-20.59	ING Precious Metals	-13.31
Grand Prix A	-19.39	Fidelity Select Electronics	-13.13
ProFunds Precious Metals Ultrasector Inv.	-18.93	USAA Precious Metals & Minerals	-13.08
Van Wagoner Emerging Growth	-18.52	Fidelity Select Gold	-12.67
Van Wagoner Small Cap Growth	-18.31	Gabelli Gold A	-12.67
Choice Long Short A	-18.17	Comstock Capital Value A	-12.54
Frontier Equity	-17.24	Leuthold Grizzly Short	-11.79
Potomac Small Cap/Short Inv.	-16.99	Firsthand Global Technology	-11.50
Rydex Dynamic Tempest 500	-16.77	Scudder Gold & Precious Metals S	-11.41
iShares Goldman Sachs Semiconductor Index	-16.63	Comstock Strategy O	-11.21
ProFunds UltraBear Inv.	-16.40	Rydex Arktos Inv.	-10.80
AXP Precious Metals Y	-16.28	ProFunds Short OTC Inv.	-10.66
Ehrenkrantz Growth	-15.95	PIA Equity	-10.50
Firsthand Technology Innovators	-15.83	American Century Global Gold Inv.	-10.31

*Appreciation plus reinvestment of dividends and capital gains before taxes. Dec. 31, 2003-Dec. 10, 2004 Data: Standard & Poor's

gories. While oil stocks have soared, Dan Rice, manager of State Street Research Global Resources Fund, which is up 40.60% this year, sees better prospects in other energy plays, especially coal stocks, which comprise 25% of his fund. "Coal prices have risen dramatically, but the supply of coal hasn't really increased," he says. That makes Rice think shares of coal miners such as Peabody Energy Corp. and Consol Energy Inc. could more than double.

Real estate investment trusts have risen consistently every year since the bear market began in 2000, and the average REIT fund gained 29.35% this year. Co-manager James S. Corl of Cohen & Steers Realty Focus Fund, up 36.94% year-to-date, says REITs on average have traded at a 4% or 5% premium to the value of their real estate holdings since 1987. Currently they're trading at an 8% premium, he says, making them slightly overvalued. Corl looks for REITs that trade at a discount to their properties. Among those is Host Marriott Corp., which stands to benefit from higher occupancies and rising room rates.

What about technology funds? After a

sharp rebound in 2003, they have sagged in 2004, gaining only 1.40%, though certain areas shined. "The two I like are the Internet and wireless data—Yahoo!, eBay, Ericsson," says co-manager Walter Price of Pimco RCM Dresdner Global Technology Fund, one of the category's top performers this year, with a 15.48% gain. A

bigger question mark hangs over the chip and hardware sectors, which are suffering from overcapacity. Price thinks inventory adjustments may depress earnings for six more months, but the stocks may rise sooner in anticipation of a recovery.

Managers of diversified funds aren't keen about tech. "There's increased competition and a lack of killer applications," says Edward P. Bousa, co-manager of the \$33 billion Vanguard Wellington Fund, a balanced fund that can in-

vest in almost any kind of stock or bond. "The sector needs some kind of great new product to spark demand." One of the few tech stocks he owns is Apple Computer Inc. because he believes the iPod digital music player is one of those great products.

Of greater interest to Bousa are foreign stocks; they account for 15% of his portfolio, high for what is primarily a U.S.-focused fund. Indeed, almost every manager *BusinessWeek* spoke to who had the flexibility to invest globally preferred stocks overseas, which have cheaper valuations and can benefit from a falling U.S. dollar. "I'm very confident that non-U.S. equities will beat U.S. ones over the next five years," says GMO's Inker. He is so confident that he's buying foreign stocks while short-selling U.S. equities in some of GMO's private accounts.

Manager Bernard R. Horn Jr. of the top-performing Polaris Global Value Fund, which has a 18.77% return so far this year, ranks entire stock markets of 44 countries by their relative valuations. The U.S., he says, is near the bottom. Poland tops the list, while Japan, China, Taiwan, Korea, Indonesia, and Hungary rank highly. He especially likes Japanese utility companies Tokyo Electric Power Co. and Kansai Electric Power Co., which have price-to-cash-flow ratios that are about half those of comparable U.S. utilities.

Emerging markets still offer the best

The Giant Equity Funds

FUND	NET ASSETS (BILLIONS)	TOTAL RETURN*
Vanguard 500 Index Inv.	\$78.7	8.46%
Fidelity Magellan	61.7	5.54
Investment Company of America A	61.1	7.67
Washington Mutual Investors A	59.3	7.71
Growth Fund of America A	55.3	8.76
Standard & Poor's Depositary Receipts	46.7	8.47
Fidelity Contrafund	40.1	11.84
Income Fund of America A	39.1	9.60
Dodge & Cox Stock	38.4	15.51
EuroPacific Growth A	33.5	13.60

*Appreciation plus reinvestment of dividends and capital gains before taxes. Dec. 31, 2003-Dec. 10, 2004 Data: Standard & Poor's



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Smart Strategies Mutual Funds

bargains even though the funds have outperformed the S&P 500 for each of the past four years. Co-manager John Chisholm of Prudential Emerging Markets Fund, up 20.40% this year, figures the price-earnings multiples of emerging-markets stocks are 40% less, on average,

than those of U.S. stocks. But he cautions that valuation alone isn't enough to prompt an investment. He also considers a country's interest rates, market volatility, and political corruption before buying stocks there. If any of those indicators are rising, as they are in Brazil, Mexico, and

Pakistan, it's a red light. He's looking more favorably on Russia and Turkey.

Emerging-market bonds have done even better than the sector's stocks, earning double-digit gains each year since the debt crisis of 1998 and rising 10.55% in 2004. Whether the rally continues depends on the U.S., says Mohamed Erian, portfolio manager of the \$1.7 billion Pimco Emerging Markets Bond Fund. If the dollar plummets and U.S. interest rates spike, he says, riskier investments such as emerging markets get slammed as investors flee to cash or gold. If the U.S. continues to muddle along with just a weak dollar, emerging-market bonds should continue to outperform lower-yielding U.S. Treasuries.

Equity Funds Are Still Going Strong

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
Real Estate	29.35%	All Cap	9.14%
Latin America	27.85	Pacific/Asia ex-Japan	8.64
Natural Resources	25.31	Miscellaneous	8.47
Communications	19.68	Large-cap Blend	7.25
Utilities	18.73	Diversified Pacific/Asia	7.08
Europe	17.99	Small-cap Growth	6.95
Small-cap Value	15.67	Health	6.55
Diversified Emerging Markets	14.88	Domestic Hybrid	6.16
Mid-cap Value	14.28	Large-cap Growth	5.46
Small-cap Blend	13.99	Japan	3.56
Foreign	12.76	Technology	1.40
Mid-cap Blend	12.24	Precious Metals	-9.08
Financial	11.03		
World	10.42	International Equity Funds	12.50
Large-cap Value	9.85	All Equity Funds	9.57
International Hybrid	9.78	U.S. Diversified Funds	9.05
Mid-cap Growth	9.25	S&P 500	8.52

*Appreciation plus reinvestment of dividends and capital gains before taxes, Dec. 31, 2003-Dec. 10, 2004
Data: Standard & Poor's

Bond Funds Remain in the Black

CATEGORY	TOTAL RETURN*	CATEGORY	TOTAL RETURN*
Emerging Markets Bond	10.55%	Intermediate Government	3.36%
High Yield	8.79	Muni. California Intermediate	2.84
Multisector	7.54	Muni. New York Intermediate	2.79
International Bond	7.31	Muni. National Intermediate	2.68
Long Government	6.36	Muni. Single-State Intermediate	2.61
Long (General)	6.31	Short Government	1.89
Convertibles	6.14	Short (General)	1.58
Muni. High Yield	5.37	Ultrashort	1.57
Muni. California Long	4.10	Muni. Short	1.09
Intermediate (General)	3.84		
Muni. National Long	3.67	All Taxable Bond Average	4.59
Muni. Single-State Long	3.42	All Bond Average	3.93
Muni. New York Long	3.37	All Nontaxable Bond Average	3.14

*Appreciation plus reinvestment of dividends and capital gains before taxes, Dec. 31, 2003-Dec. 10, 2004
Data: Standard & Poor's

VENTURING BEYOND

CERTAINLY, THE QUEST for yield has led bond investors to take on more risk. Average junk-bond yields have dropped from over 12% during the bear market to 7% today as yield-hungry buyers have poured billions into junk funds. Yet manager James Kelsoe of Regions Morgan Keegan Select High Income Bond Fund has been able to deliver a 9.8% current yield by investing in smaller, lesser-known bond issuers and by venturing out to more exotic investments such as collateralized home-equity loans and credit card receivables. Kelsoe worries that interest rates on the new-issue high-yield bonds are only around three percentage points higher than Treasuries—that's not enough extra return to compensate for the extra risk.

For this reason tax-free municipal bond funds may be a better bet. According to manager John Miller of the top performing Nuveen High Yield Municipal Bond Fund, the average high-yield muni bond yields 6.6%. That translates into 10.1% for investors in the highest tax brackets. High-quality munis also look good relative to Treasuries. "You get 95% of a 10-year Treasury's yield on an AAA-rated muni bond of an equivalent maturity," Miller says, and it's tax-free.

Other than munis, attractive bond market opportunities are scarce. "I can't imagine any investor not doing better in a portfolio of high-quality equities than in bonds," says Oakmark's Nygren. Sure, that's a stock-fund manager talking, but looking into 2005 at least, many bond fund managers would probably agree. ■

BusinessWeek online For a Q&A with Brandywine Blue's Bill D'Alonzo, go to www.businessweek.com/magazine/extra.htm

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Mining The Numbers

Our scoreboard can yield investment gold. Here's how. **BY ROBERT J. ROSENBERG**

ASK INVESTORS ABOUT the market in 2004, and the most likely description you'll hear is "mediocre." Had the question been posed before the recent rally, the answer would have been unprintable. Following a strong 2003, many stocks spent the year treading water. But those that made it through our Investment Outlook screens averaged a 16.1% return from Dec. 31 through Nov. 30, handily beating the Standard & Poor's 500-stock index, the NASDAQ Composite index, and the Dow Jones industrial average, which returned 7.2%, 5.1%, and 1.7%, respectively.

Sure, past performance is no guarantee for the future. But our lists are a good place to look for stocks that may outperform the market. The stocks are drawn from the 900 publicly traded companies on the Investment Outlook Scoreboard. These companies are chosen on the basis of sales and market capitalization. They must also have a share price of \$1 or more.

There are dozens of ways to slice the data—and to get you started, we've done it eight ways. We've sorted the tables on traditional value criteria such as stocks with low price-to-book-value ratios and high dividend yields. We've taken the growth investors' tack, too, with a leader-of-the-pack list made up of companies whose return on equity is

JACK BLACK



Mining the Numbers Scoreboard

THE FOLLOWING EIGHT TABLES ARE DESIGNED TO HELP YOU FIND WINNERS

higher than the industry and whose projected earnings growth is expected to beat its peers. We also have a screen for high-yielding mid-cap stocks. That's a sector often overlooked by dividend hunters.

Those whose idea of fun is poking about flea markets may like our cheap-stock screen. Investors have dumped shares of these outfits because they're in troubled industries or are having earnings problems. Seven on this year's list are in the insurance industry, the current target of investigations by New York State Attorney General Eliot Spitzer. But for some of them, it may be a case of guilt by association. LandAmerica Financial Group, a title insurer in Richmond, Va., is well out of Spitzer's crosshairs, but the market is worried that the company will falter if rising mortgage rates slow the sales of houses. If the market has overreacted, LandAmerica could be a steal.

Still, inexpensive stocks are usually down for a good reason. General Motors Corp. is one in this category—because investors fear that rising health-care costs will hurt GM's ability to innovate and pay its dividend.

Value investors looking to hedge their bets ought to scan our low-price-to-book list. All of the stocks carry an S&P equity rank—which measures financial soundness—of at least A-. Along with the usual financial firms, such as Bear, Stearns & Co., is one telecom company, CenturyTel Inc. Although many investors look askance at the boom-and-bust telecom industry, CenturyTel is quite a different

kettle of fish: It operates in rural areas where it has little competition. S&P analysts say that the cost-cutting measures at CenturyTel should ensure that cash flow continues to grow—and they remain bullish on the stock.

Another telecommunications-related stock, wireless-equipment supplier Andrew Corp., is a worthy name on our list of mid-cap stocks. Wall Street analysts are forecasting a double-digit rise in its sales and a 175% increase in its earnings. Andrew, an important supplier for Cingular Wireless LLC, may benefit from the merger of Cingular and AT&T Wireless as the combined entity builds additional capacity.

Technology stocks have disappointed many during the past year, especially since 2003 was so strong. In 2005, investors may be pleasantly surprised with the stock performance because expectations are low and any surprises should be to the upside. Two promising names on our high-tech stock screen are KLA-Tencor Corp. and Chiron Corp.

KLA-Tencor makes the quality-control-monitoring equipment that is used by chipmakers. Sales in the first quarter of its 2005 fiscal year climbed about 60% and analysts expect earnings to rise 83% for the year.

Shares of biotech company Chiron

Cheap Stocks

Companies with both low price-to-book and low price-earnings ratios.

COMPANY (SYMBOL)	PRICE AS PERCENT OF BOOK VALUE	P-E RATIO
General Motors (GM)	78%	7.2
LandAmerica Financial Group (LFG)	85	7.0
American Financial Group (AFG)	103	4.4
PartnerRe (PRE)	116	7.6
Odyssey Re Holdings (ORH)	112	8.6
First American (FAF)	123	8.0
Stewart Information Services (STC)	116	9.6
Trans World Entertainment (TWMC)	99	10.8
ACE (ACE)	121	9.2
Dana (DCN)	109	10.5

Low-Price-to-Book Stocks

Companies also have an S&P equity ranking of at least A-.

COMPANY (SYMBOL)	PRICE AS A PERCENT OF BOOK VALUE	S&P EQUITY RANKING
Old Republic International (ORI)	120%	A
Cincinnati Financial (CINF)	124	A-
CenturyTel (CTL)	130	A
Lafarge North America (LAF)	131	A
Bear Stearns (BSC)	131	A
MBIA (MBI)	132	A
Everest Re Group (RE)	134	A-
Radian Group (RDN)	135	A
Pinnacle West Capital (PNW)	136	A
Protective Life (PL)	137	A

Small- and Mid-Caps To Watch

These companies' profits are projected to skyrocket next year.

COMPANY (SYMBOL)	PRICE CHANGE DEC. 31, 2003-NOV. 30, 2004	CHANGE IN EARNINGS 2004-05
Massey Energy (MEE)	69%	521%
Rock-Tenn (RKT)	-6	337
PMA Capital (PMACA)	94	333
Consol Energy (CNX)	65	237
Pride International (PDE)	5	216
Crompton (CK)	56	213
McDermott International (MDR)	38	190
Andrew (ANDW)	23	175
Packaging Corp. of America (PKG)	5	170
Arch Coal (ACI)	23	151

High-Tech Earners for 2005

Outfits projected to deliver a superior tech earnings performance in the coming year.

COMPANY (SYMBOL)	PRICE CHANGE DEC. 31, 2003-NOV. 30, 2004	CHANGE IN EARNINGS 2004-05
Electronic Data Systems (EDS)	-9%	196%
Andrew (ANDW)	23	175
Micron Technology (MU)	-18	175
Avnet (AVT)	-15	128
Chiron (CHIR)	-43	123
UTStarcom (UTSI)	-47	113
BearingPoint (BE)	-14	96
Apple Computer (AAPL)	214	92
KLA-Tencor (KLAC)	-23	83
Agilent Technologies (A)	-22	69

Data: Thomson First Call, Standard & Poor's Compustat
Prices as of Nov. 30, 2004; other data as of Dec. 1.



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Mining the Numbers Scoreboard

High-Tech Long-Term Growth

Tech companies set to show higher-than-average earnings growth for the long haul.

COMPANY (SYMBOL)	PRICE CHANGE DEC. 31, 2003- NOV. 30, 2004	LONG-TERM EARNINGS GROWTH*
Google (GOOG)	NA	34.0%
Yahoo! (YHOO)	67%	30.0
Telephone & Data Systems (TDS)	24	28.5
Genentech (DNA)	3	28.3
Jabil Circuit (JBL)	-11	25.0
Maxim Integrated Products (MXIM)	-17	25.0
Iron Mountain (IRM)	14	23.0
Gilead Sciences (GILD)	18	21.0
Apple Computer (AAPL)	214	20.0
Biogen Idec (BIIB)	60	20.0

*Annualized three to five years

Leaders of the Pack

Companies whose ROE and projected earnings growth beat the industry average.

COMPANY (SYMBOL)	RETURN ON EQUITY	CHANGE IN EARNINGS 2004-05
Sears, Roebuck (S)	50.2%	45%
Coach (COH)	36.3	32
Apollo Group (APOL)	29.0	212
Dow Chemical (DOW)	25.7	50
Boston Scientific (BSX)	22.5	35
International Game Technology (IGT)	21.7	30
Cisco Systems (CSCO)	21.5	27
Maxim Integrated Products (MXIM)	21.4	36
Halliburton (HAL)	20.8	27
North Fork Bancorporation (NFB)	17.6	26

Big-Caps with Big Yields

Minimum market capitalization for companies in this category is \$5 billion. Utilities and REITs are excluded.

COMPANY (SYMBOL)	YIELD
Merck (MRK)	5.4%
AT&T (T)	5.2
General Motors (GM)	5.2
Altria Group (MO)	5.1
Reynolds American (RAI)	5.0
SBC Communications (SBC)	5.0
Bristol-Myers Squibb (BMY)	4.8
Marsh & McLennan (MMC)	4.8
UST (UST)	4.7
Washington Mutual (WM)	4.4

Mid-Caps with High Yields

Market capitalization between \$1 billion and \$5 billion. Utilities and REITs excluded.

COMPANY (SYMBOL)	YIELD
Citizens Communications (CZN)	7.0%
Carolina Group (CG)	6.2
Regal Entertainment Group (RGC)	5.8
Deluxe (DLX)	3.7
Maytag (MYG)	3.6
Olin (OLN)	3.5
Unitrin (UTR)	3.5
ServiceMaster (SVM)	3.3
Arthur J. Gallagher (AJG)	3.3
RPM International (RPM)	3.2

Data: Thomson First Call, Standard & Poor's Compustat

Prices as of Nov. 30. All other data as of Dec. 1

have fallen by about 33% since Oct. 4, when British regulators shut down a flu-vaccine plant after finding evidence of contamination, leading to the vaccine shortage in the U.S. If Chiron can fix its vaccine-manufacturing problems, the stock may be a bargain.

Another technology list that screens for above-average long-term growth projections turned up Genentech Inc. and Yahoo! Inc. Genentech's Avastin cancer drug stands a chance of reaching \$5 billion in sales, and the company has additional drugs in the pipeline, including one used for treating age-related degenerative eye disease.

Yahoo's growth in profits and revenues—and share price—has been nothing

short of phenomenal. Where will the future growth come from? One promising field is wireless, given its purchase of technology that lets people move songs and photographs to mobile devices. With its focus on simplicity and breadth of offerings, Yahoo could dominate the wireless Web.

Stockpickers should love our leaders-of-the-pack screen. It turns up an eclectic bunch, including companies that are outperforming their peers in various industries. Near the top is Coach Inc., a venerable name in leather goods and handbags. Since going public in 2000, Coach's sales have more than doubled, while earnings have soared almost sevenfold. In the next few years, the company expects to open an additional 100 stores, many of

of them located abroad. As the leader in drug-coated stents that open up narrowed arteries, Boston Scientific is on a roll after stumbling badly last summer. The company had to recall about 90,000 stents. The stock cratered, but the company fixed the problem and earnings are moving up nicely. They're expected to climb 35%, to \$2.19 in 2005.

Our big-dividend-payers list is dominated by cigarette companies and drugmakers—an interesting combination given that Merrill Lynch & Co. Chief U.S. Strategist Richard Bernstein has dubbed Big Pharma, with all its legal problems over drugs such as Vioxx, “potentially the new tobacco stocks.” If he's right, beaten-down drug stocks could offer real buying opportunities. Recall that Altria Group, formerly Philip Morris Cos., continues to pay high dividends as it fights all its lawsuits. Between dividends and price appreciation, Altria has had an average annual return of 24.1%, vs. the S&P 500's -1.8% over the past five years.

For those who say no to drugs and tobacco, we offer up our mid-cap high-yield list. Rural-based Citizens Communications Co. yields 7.0%. Although there's

some concern about the debt on its balance sheet, Citizens is moving to refinance that debt, notes Legg Mason Wood Walker analyst Christopher Walker, who rates Citizens a “buy.”

Deluxe Corp., a check printer, yields 3.7%. To offset the decline in the number of checks being written nowadays—as a result of electronic payments—Deluxe is diversifying through its 2004 acquisition of New England Business Service, a provider of business forms.

Our lists, of course, are just a starting point. The Scoreboard is filled with information to make smart picks. So when 2005 comes to an end and someone asks how you did in the market, your answer can be: Pretty darn good. ■

Investment Outlook Scoreboard 2004

Here are the figures to help you size up 900 companies

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE				
												ESTIMATES FROM ANALYSTS				
												2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
ALL-INDUSTRY AVERAGE	13500.1	133	15	9.9	15.3	512	25	1.6	14.9	2.4	1.18	7.63	5.60	6.97	12.1	
CONSUMER DISCRETIONARY																
SECTOR AVERAGE	8126.1	44	13	13.3	17.1	370	24	1.2	15.1	1.7	0.83	2.14	2.51	3.05	13.9	
1 AUTOMOBILES & COMPONENTS																
INDUSTRY GROUP AVERAGE	5629.0	27	5	0.5	13.0	225	15	0.4	10.3	2.1	1.48	0.72	2.16	2.43	10.5	
(A) AUTO COMPONENTS																
INDUSTRY AVERAGE	2826.7	26	4	1.1	12.0	203	16	0.3	4.6	2.4	1.36	0.35	1.95	2.32	10.3	
American Axle & Mfg. Holdings AXL	1447.2	29	-28	7.6	19.0	151	9	0.4	4.1	0.8	2.06	3.70	3.46	3.40	10.0	NR
ArvinMeritor ARM (9)	1523.3	22	-9	-13.6b	12.9	154	12	0.2	NA	1.1	1.82	2.06	1.85*	2.02	10.5	NR
Autoliv ALV	4309.4	47	24	9.6	13.2	176	14	0.7	7.0	1.6	2.14	2.81	3.40	3.63	8.5	NR
BorgWarner BWA	2811.9	50	18	6.1	13.8	194	14	0.8	8.4	1.1	1.12	3.20	3.66	4.23	12.3	B+
Dana DCN	2449.1	16	-11	-13.0	10.5	109	11	0.3	4.0	1.1	2.94	1.17	1.61	1.63	9.0	B-
Delphi DPH	5050.8	9	-12	NM	9.7	330	33	0.2	4.0	2.9	3.11	-0.10	0.45	0.61	7.0	NR
Dura Automotive Systems DRR	169.5	9	-30	-11.1	3.0	48	17	0.1	1.8	0.7	0.00	1.35	1.60	2.05	8.0	B-
Goodyear Tire & Rubber GT	2213.5	13	61	NM	NM	NM	NM	0.1	NA	14.5	0.00	-4.58	0.29	0.69	3.0	B-
Johnson Controls JCI (9)	11685.7	61	6	12.7c	15.7	224	14	0.4	8.6	1.1	1.63	1.80	4.24*	4.69	13.5	A+
Lear LEA	3956.1	58	-5	10.4	17.2	157	9	0.2	5.1	0.8	1.38	5.55	5.78	6.47	12.0	B+
Tenneco Automotive TEN	657.2	16	132	NM	31.7	651	21	0.2	3.2	1.9	0.00	0.65	1.18	1.42	7.0	B-
Tower Automotive TWR	105.3	2	-74	NM	-10.8	26	NM	0.0	1.0	NM	0.00	-2.20	-0.33	0.27	10.0	C
TRW Automotive Holdings TRW	2095.4	21	NA	NA	8.3	193	24	0.2	3.6	1.4	0.00	-0.81	1.71	1.88	9.0	NR
Visteon VC	1099.8	8	-19	NM	NM	226	NM	0.1	NM	NM	2.84	-9.65	-1.64	-0.55	25.0	NR
(B) AUTOMOBILES																
INDUSTRY AVERAGE	13475.5	32	7	-0.7	15.5	283	13	0.9	31.0	1.2	1.81	1.76	2.77	2.77	10.9	
Fleetwood Enterprises FLE (4)	751.5	14	32	NM	-4.4	252	NM	0.3	62.3	NA	0.00	-0.58	0.58	1.05	NA	C
Ford Motor F	25944.7	14	-11	-44.8	21.3	184	10	0.2	NA	1.1	2.82	0.50	2.11	1.98	6.0	B
General Motors GM	21795.8	39	-28	-13.4	11.0	78	7	0.1	NA	1.2	5.18	5.03	6.34	5.23	5.0	B
Harley-Davidson HDI	16987.4	58	22	30.1	27.9	549	20	3.2	15.8	1.2	0.69	2.50	2.97	3.36	16.0	A+
Thor Industries THO (7)	1898.1	33	19	25.3c	21.9	353	16	0.8	15.0	1.1	0.36	1.37	1.84*	2.21	16.5	A-
2 CONSUMER DURABLES & APPAREL																
INDUSTRY GROUP AVERAGE	4364.5	63	16	17.0	19.9	383	19	1.0	12.1	1.2	1.12	5.11	5.40	6.24	13.1	
(A) HOUSEHOLD DURABLES																
INDUSTRY AVERAGE	3950.4	75	14	15.9	21.7	406	16	0.8	11.7	1.1	1.16	5.19	7.08	8.22	13.6	
American Greetings AM (2)	1823.9	27	22	3.5	8.1	142	20	0.9	11.1	1.3	0.90	1.40	1.76	1.94	12.0	B-
Beazer Homes USA BZH (9)	1675.6	124	27	35.4c	19.1	136	7	0.4	6.7	0.5	0.32	12.78	17.09*	20.07	15.0	B+

FOOTNOTES: *Actual, not estimated data. NA=not available. NM=not meaningful. NR=not ranked. (a) Four-year compound growth rate. (b) Final year of growth rate calculation is 2003 (c) Final year of growth rate calculation is 2004 (d) Pro forma data. Data compiled by Compustat from sources such as statistical services, registration statements, and company reports that Compustat believes to be reliable but are not guaranteed by Compustat or BusinessWeek as to correctness or completeness. This material is not an offer to buy or sell any security. Additional data: Thomson First Call.

The Glossary

A quick guide to what is included in these tables

MARKET VALUE: Share price on Nov. 30, 2004, multiplied by the latest available common shares outstanding.

RECENT SHARE PRICE: Price for a single share of a company's most widely traded issue of common stock as of the close of trading Nov. 30, 2004.

PRICE CHANGE: Percentage change in the company's most widely traded common-stock issue since Dec. 31, 2003.

EARNINGS GROWTH: Compound annual growth rate, calculated using the 1999 and 2003 restated basic earnings per share (unless noted otherwise).

RETURN ON EQUITY: The latest available net income available for shareholders divided by total equity.

PRICE AS PERCENTAGE OF BOOK VALUE: Share price on Nov. 30, 2004, as a percentage of the latest available book value per share, which is the sum of common stock at nominal balance-sheet value, capital surplus, and retained earnings as shown in company accounts divided by the number of shares outstanding.

P-E RATIO: Price-earnings ratio based on the latest available 12 months earnings and Nov. 30, 2004, stock price.

PRICE-SALES RATIO: Based on the latest available 12 months sales and the Nov. 30, 2004, stock price.

PRICE-CASH FLOW RATIO: The Nov. 30, 2004 stock price divided by the latest available 12 months

cash flow. Cash flow is equal to income from continuing operations before extraordinary items plus depreciation and amortization.

PRICE-EARNINGS TO GROWTH RATE: The price-earnings ratio based on the 2004 earnings estimate and Nov. 30, 2004, stock price, divided by the long-term earnings growth rate.

DIVIDEND YIELD: Indicated annual dividend as a percent of the Nov. 30, 2004, stock price.

EARNINGS PER SHARE: Diluted earnings per share—net income (including proceeds from certain convertible securities, warrants, and options that are common-stock equivalents, but excluding extraordinary profits or losses)

divided by number of common and common equivalent shares.

EARNINGS PER SHARE ESTIMATES: Analysts' consensus estimates for 2004 and 2005 compiled by Thomson First Call.

LONG-TERM EARNINGS GROWTH: The median estimate by analysts of the annual growth rate of earnings compiled by Thomson First Call. For most companies, this is for the next 3-5 years.

S&P EQUITY RANKING: A measure of a company's historical growth of earnings and dividends, using Standard & Poor's computerized scoring system based on the most recent 10 years of earnings per share and dividends.

COMPANY	MARKET VALUE	PERCENT SHARE PRICE	2004 PRICE CHANGE	2004 EARNINGS PER SHARE	2003 RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P/E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P/E TO GROWTH RATE	YIELD %	2003 ACTUAL	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
													2004 ANALYST EST	2005 CONSENSUS	LONG-TERM GROWTH RATE %		
Black & Decker BDK	6730.3	84	70	2.2	32.1	539	17	1.4	12.6	1.6	1.00	3.68	5.34	6.02	10.0	B+	
Blyth Blyth	1198.8	29	-9	0.3	17.0	261	17	0.8	10.0	NA	1.30	1.88	2.07	2.32	NA	B+	
Context CTX	565.7	52	-3	40.4	24.2	187	8	0.6	6.9	0.5	0.30	6.01	7.31	8.42	15.0	A+	
Foamex International FMI	98.8	4	-19	NM	NM	NM	NM	0.1	NM	NM	0.00	-0.88	-0.25	0.23	NA	B-	
Forume Brands FBL	11313.1	78	10	NM	24.0	394	17	1.7	12.5	1.4	1.68	3.86	4.60	5.06	12.0	B	
Furniture Brands International FBN	1301.5	24	-17	-6.2	9.6	136	15	0.5	9.2	1.3	2.47	1.68	1.60	1.90	11.5	B+	
Harman International Industries HAR (6)	8170.3	123	66	22.7c	18.5	879	50	2.9	31.0	2.2	0.04	1.55	2.27*	3.02	25.0	B+	
Horton (D.R.) DHI (9)	8207.5	35	22	38.8c	24.6	207	9	0.8	8.0	0.6	0.91	2.73	4.11*	4.62	15.0	A	
Hovnanian Enterprises HOV (10)	2460.0	40	-7	65.3c	29.2	206	8	0.6	6.4	0.3	0.00	3.93	5.35*	6.31	26.8	B	
KB Home KBH (11)	3421.3	88	21	31.4	23.7	187	9	0.5	7.5	0.7	1.14	8.80	11.10	13.44	12.1	A	
La-Z-Boy LZB (4)	799.6	15	-27	-58.0	-2.7	154	NM	0.4	54.5	1.8	2.87	0.05	0.78	1.04	11.0	A-	
Leggett & Platt LEG	5698.3	30	38	-7.9	12.5	255	21	1.2	12.5	1.3	2.01	1.05	1.47	1.68	15.5	B+	
Lennar LEN (11)	7014.8	45	-6	NA	23.0	190	9	0.7	7.8	0.6	1.22	4.65	5.61	6.34	14.1	A-	
M.D.C. Holdings MDC	2486.6	76	29	24.7	25.0	197	8	0.7	7.0	0.4	0.79	6.36	10.79	11.44	15.9	A+	
Maytag MYG	1590.9	20	-28	-21.3	59.4	3983	67	0.3	8.1	2.0	3.58	1.45	0.97	1.50	10.5	B+	
Meritage Homes MTH	1200.3	94	41	42.6	25.4	256	11	0.7	9.2	1.0	0.00	6.84	9.40	11.08	10.0	B-	
Mohawk Industries MHK	5842.8	88	24	15.5	14.4	228	16	1.0	11.9	1.2	0.00	4.62	5.48	6.14	13.0	B+	
Newell Rubbermaid NWL	6333.2	23	1	NM	-21.8	389	NM	0.9	NM	1.8	3.64	-0.17	1.36	1.49	9.5	B+	
NVR NVR	4423.1	691	48	53.5	75.9	683	11	1.1	8.8	0.8	0.00	48.39	67.01	78.44	12.5	B+	
Pulte Homes PHM	7048.7	55	18	25.1	20.2	172	9	0.7	8.1	0.5	0.36	4.91	7.47	8.62	15.0	A	
Ryland Group RYL	2396.7	51	14	44.3	31.1	250	9	0.6	7.1	0.7	0.39	4.56	6.26	7.00	11.5	B+	
Snap-on SNA	1824.3	32	-2	-11.3	7.5	182	25	0.8	13.0	1.9	3.16	1.35	1.38	1.69	12.0	B	
Standard Pacific SPF	1874.9	56	15	28.8	21.7	159	8	0.6	NA	0.5	0.57	6.08	8.75	9.68	13.0	NR	
Stanley Works SWK	3846.5	47	23	-8.9	19.6	351	18	1.2	12.6	1.2	2.40	1.14	2.91	3.24	13.0	B	
Toll Brothers TOL (10)	3820.2	51	29	28.6c	21.3	199	10	1.0	8.9	0.7	0.00	3.44	5.04	6.15	15.0	B+	
WCI Communities WCI	1142.7	26	24	2.4	14.5	137	10	0.7	8.5	0.7	0.00	2.34	2.48	3.46	15.0	NR	
Whirlpool WHR	4260.3	65	-11	6.9	31.4	309	10	0.3	4.9	1.6	2.66	5.91	5.88	5.99	7.0	B	
(B) LEISURE EQUIPMENT & PRODUCTS																	
INDUSTRY AVERAGE	5618.3	37	23	10.0	18.8	391	24	1.2	10.4	1.8	1.56	1.39	2.13	2.38	10.2		
Brunswick BC	4692.8	49	53	-1.3	15.0	280	19	0.9	11.5	1.3	1.23	1.47	2.74	3.39	14.0	B	
Eastman Kodak EK	9355.1	33	27	-34.0	5.6	247	44	0.7	8.7	2.6	1.53	0.83	2.54	2.56	5.0	B-	
Hasbro HAS	3367.8	19	-11	1.0	12.7	224	20	1.1	9.7	1.6	1.26	0.98	1.21	1.36	10.0	B	
Mattel MAT	7860.5	19	-2	48.9	22.3	350	16	1.6	11.6	1.6	2.37	1.22	1.16	1.24	10.0	B+	
Polaris Industries PII	2815.2	66	49	35.2	38.6	854	23	1.7	NA	1.8	1.40	2.46	3.00	3.36	12.0	A-	
(C) TEXTILES, APPAREL, & LUXURY GOODS																	
INDUSTRY AVERAGE	4842.8	43	16	23.1	16.0	324	23	1.4	13.9	1.3	0.83	6.47	2.68	3.07	13.2		
Brown Shoe BWS (1)	518.8	29	-25	7.4	10.3	133	13	0.3	8.1	1.3	1.40	2.52	2.41	2.79	8.9	B	
Coach COH (6)	9401.9	50	32	49.8c	36.3	1190	33	6.7	28.1	1.8	0.00	0.79	1.36*	1.80	20.0	NR	
Jones Apparel Group JNY	4373.7	36	1	11.8	11.6	165	15	1.0	10.5	1.2	1.13	2.48	2.54	3.06	12.0	B+	
Kellwood KWD (1)	962.7	35	-15	16.5	10.6	134	13	0.4	NA	1.1	1.84	2.68	2.73	3.11	11.5	B+	
Liz Claiborne LIZ	4446.0	41	16	13.6	17.4	255	15	1.0	10.7	1.3	0.55	2.55	2.84	3.11	11.0	A	
Nike NKE (5)	22223.3	85	24	14.3	20.1	443	23	1.7	17.5	1.5	1.18	3.51	4.22	4.75	13.0	A	
Phillips-Van Heusen PVH (1)	845.4	27	54	NM	1.9	262	85	0.5	16.4	1.4	0.55	-0.18	1.30	1.52	15.0	B-	
Polo Ralph Lauren RL (3)	4011.6	39	37	3.8	13.4	260	20	1.4	13.6	1.5	0.51	1.69	2.45	2.91	11.0	NR	
Reebok International RBK	2265.4	39	-1	90.8	15.1	198	14	0.6	10.8	1.0	0.77	2.43	2.95	3.33	13.4	B	
Timberland TBL	2193.4	63	22	17.4	29.4	438	15	1.5	12.7	1.1	0.00	3.23	4.25	4.75	14.0	B	
VF VFC	5965.3	54	25	5.3	19.0	252	13	1.0	10.4	1.7	2.00	3.61	4.07	4.39	8.0	B+	
Warnaco Group WRNC	906.0	20	25	NA	7.4	164	23	0.7	NA	0.9	0.00	52.34	1.05	1.33	20.0	NR	
3 HOTELS, RESTAURANTS, & LEISURE																	
INDUSTRY GROUP AVERAGE	9958.4	40	33	6.6	13.9	352	27	1.8	14.3	1.8	0.87	1.30	1.77	2.07	13.0		
Boyd Gaming BYD	3197.1	37	128	-0.4	8.6	358	35	2.1	16.5	1.8	0.92	0.62	1.31	1.70	15.9	B	
Brinker International EAT (6)	3300.0	34	3	7.5c	14.0	373	26	0.9	10.9	1.4	0.00	1.70	1.57*	2.10	15.0	B+	
Caesars Entertainment CZR	5844.9	19	74	-21.7	2.4	171	75	1.3	11.7	2.7	0.00	0.18	0.71	0.78	10.0	NR	
Carnival CCL (11)	42567.0	53	33	-0.3	11.5	278	25	4.6	16.8	1.8	1.13	1.66	2.20	2.69	13.5	A+	
CBRL Group CBRL (7)	1970.1	41	7	22.8c	13.1	225	18	0.8	10.9	1.2	1.18	2.09	2.25*	2.64	15.0	B+	
Darden Restaurants DRI (5)	4285.7	27	30	11.5	18.5	337	19	0.9	9.6	1.4	0.29	1.36	1.66	1.82	12.0	A-	
Domino's Pizza DPZ	1232.4	18	NA	NA	NM	NM	12	0.9	NA	1.6	1.45	-0.11	1.14	1.25	10.0	NR	
Harrah's Entertainment HET	6874.2	61	23	NM	15.6	351	23	1.6	10.9	1.2	2.15	2.64	3.30	3.63	15.0	B	
Hilton Hotels HLT	7975.3	21	21	-10.2	9.7	323	33	1.9	13.9	2.7	0.39	0.43	0.59	0.76	13.0	B	
International Game Technology IGT (9)	12336.8	35	-1	24.9c	21.7	624	30	5.0	NA	2.0	1.36	1.07	1.18*	1.53	15.0	B+	
Jack in the Box JBX (9)	1390.8	38	77	-4.6c	13.6	241	18	0.6	9.3	1.9	0.00	1.99	2.12*	2.44	9.5	B	
Mandalay Resort Group MBG (1)	4705.2	70	56	35.6	19.9	398	20	1.7	11.6	1.3	1.55	2.31	3.57	3.95	15.0	B	
Marriott International MAR	12712.3	57	23	0.3a	15.3	338	24	1.3	17.0	1.6	0.60	1.94	2.43	2.83	15.0	B+	
McDonald's MCD	38646.3	31	24	-4.7	15.5	298	19	2.1	12.1	2.0	1.79	1.18	1.92	1.99	8.1	A	
MGM Mirage MGG	8085.2	58	55	18.4	13.8	307	23	1.9	10.7	1.8	0.00	1.56	2.43	2.62	13.0	B	
Outback Steakhouse OSI	3195.3	43	-2	11.7	15.3	295	20	1.0	12.1	1.3	1.20	2.17	2.18	2.54	15.0	B+	
Royal Caribbean Cruises RCL	9874.3	50	43	-9.4	10.1	207	22	2.2	11.4	1.8	1.31	1.42	2.34	2.78	12.0	A-	
Six Flags PKS	452.2	5	-35	NM	-12.1	48	NM	0.4	33.0	NM	0.00	-0.90	-0.94	-0.61	5.0	C	

Investment Outlook Scoreboard

EARNINGS PER SHARE

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
arbucks SBUX (9)	22358.1	56	70	25.3b	15.8	899	59	4.2	33.3	3.0	0.00	0.67	0.95*	1.16	20.0	B+
arwood Hotels & Resorts Worldwide HOT	10768.9	52	45	NA	7.4	230	32	2.1	14.0	2.3	1.61	0.51	1.49	1.86	15.0	NR
endy's International WEN	4055.4	36	-9	10.9	13.7	216	16	1.2	9.3	1.3	1.35	2.05	2.22	2.43	12.0	A-
JM! Brands YUM	13256.8	45	32	0.6	47.5	876	19	1.5	11.5	1.7	0.88	2.02	2.35	2.61	11.5	NR

MEDIA

INDUSTRY GROUP AVERAGE	16478.9	61	-6	9.1	11.7	518	38	2.1	29.9	2.9	0.77	1.41	1.35	2.38	13.3	
DVO AD (9)	1072.5	35	11	0.2c	34.4	756	22	0.9	12.7	1.5	1.25	1.64	1.59*	1.81	15.0	B+
MC Entertainment AEN (3)	716.6	19	27	NM	-16.9	248	NM	0.4	6.2	NM	0.00	-1.28	-0.16	0.30	12.0	C
elo BLC	2896.0	25	-11	-7.0	7.7	183	24	1.9	13.1	1.5	1.51	1.11	1.32	1.31	13.0	B
ablevision Systems CVC	6131.4	21	-9	NM	NM	NM	NM	1.3	11.4	NM	0.00	-0.99	-1.58	-0.69	12.0	B-
harter Communications CHTR	658.4	2	-46	NM	NM	NM	NM	0.1	NM	NM	0.00	-0.82	-14.06	-2.52	5.0	NR
lear Channel Communications CCU	19316.8	34	-28	62.0	5.6	133	25	2.1	12.8	1.7	1.48	1.85	1.38	1.56	14.0	B-
omcast CMCSA	66685.6	30	-8	NM	2.3	162	73	3.4	15.9	5.2	0.00	-0.10	0.36	0.64	16.0	C
ox Communications COX	21936.0	35	1	NM	1.5	219	151	3.5	12.6	6.2	0.00	-0.22	0.43	0.73	13.0	C
IRECTV Group DTV	22150.3	16	-3	NM	-13.9	285	NM	2.0	NM	NM	0.00	-0.21	-1.26	0.24	30.0	C
isney (Walt) DIS (9)	53717.0	27	15	18.4c	9.0	206	24	1.7	15.1	2.0	0.78	0.65	1.12*	1.23	12.0	B
ow Jones DJ	3503.0	43	-14	-8.7	88.8	2875	32	2.1	16.5	1.6	2.34	2.08	1.24	1.55	22.0	B
choStar Communications DISH	14901.2	33	-4	NM	NM	NM	102	2.2	24.6	2.0	0.00	0.46	0.54	1.68	30.0	C
ox Entertainment Group FOX (6)	28649.1	29	1	63.8c	7.0	157	22	2.3	19.8	1.7	0.00	1.17	1.44*	1.49	12.0	NR
annett GCI	21235.6	82	-7	8.1	16.5	269	17	2.9	13.8	1.7	1.31	4.46	4.96	5.27	9.6	A
terpublic Group IPG	5242.0	12	-20	NM	-36.2	322	NM	0.9	NM	NM	0.00	-1.43	-1.19	0.62	10.0	C
night-Ridder KRI	5245.1	68	-12	-2.5	21.8	360	17	1.7	12.5	2.2	2.03	3.63	3.89	4.20	8.0	A-
iberty Media L	28915.8	10	-13	NM	-3.5	126	NM	3.8	NM	15.5	0.00	-0.44	0.04	0.14	17.5	C
McGraw-Hill MHP	16659.9	88	25	13.8	27.3	580	22	3.3	18.5	2.0	1.37	3.58	††	††	††	NR
† Since BusinessWeek is owned by the McGraw-Hill Companies, the Scoreboard does not include forecasts of the company's earnings																
etro-Goldwyn-Mayer MGM	2815.9	12	-31	NM	-2.8	1076	NM	1.6	388.1	NM	0.00	-0.66	-0.29	-0.27	10.0	NR
ew York Times NYT	5960.0	41	-14	4.1	22.4	456	21	1.8	13.5	2.2	1.51	1.98	1.96	2.10	9.6	A-
tl NTLI	6095.2	70	0	NA	-32.1	202	NM	1.5	12.0	NM	0.00	-15.10	-9.23	-1.94	5.8	NR
omnicom Group OMC	15092.5	81	-7	14.9	19.4	414	21	1.6	17.4	1.8	1.11	3.59	3.85	4.33	11.8	A+
rimedia PRM	834.0	3	13	NM	NM	NM	NM	0.6	20.1	4.4	0.00	-0.51	0.07	0.12	10.5	C
leader's Digest Association RDA (6)	1423.3	14	-2	-22.0c	7.2	328	45	0.6	15.0	2.9	1.40	0.60	0.49*	0.81	10.0	B-
egal Entertainment Group RGC	3006.2	21	2	NA	148.0	3810	26	1.2	10.3	2.4	5.76	1.30	1.02	1.15	8.5	NR
cholastic SCHL (5)	1306.9	33	-3	-1.0	4.1	162	41	0.6	15.1	2.1	0.00	1.46	1.61	1.88	10.0	B
scripps (E.W.) SSP	7623.2	47	-1	17.3a	15.6	378	24	3.7	20.0	1.9	0.86	1.66	1.74	1.94	14.5	A-
ime Warner TWX	81062.2	18	-2	10.5	5.4	137	26	1.9	NA	2.3	0.00	0.68	0.65	0.75	12.1	C
ribune TRB	13807.2	43	-16	-17.6	9.9	209	22	2.4	15.2	1.9	1.11	2.61	2.24	2.43	10.1	A-
unitedGlobalCom UCOMA	6527.1	8	-2	2.1	-31.1	292	NM	2.9	35.8	NM	0.00	7.41	-0.48	-0.11	13.5	C
inivision Communications UVN	9728.4	30	-24	9.8	4.7	183	42	5.6	27.9	1.9	0.00	0.55	0.73	0.88	21.3	NR
Viacom VIA.B	59913.0	35	-22	12.1	2.6	94	36	2.5	23.7	1.7	0.81	0.82	1.54	1.76	13.0	B-
Washington Post WPO	8976.7	938	19	3.0	13.8	396	29	2.8	17.9	1.7	0.75	25.12	34.81	39.11	15.8	B+

RETAILING

INDUSTRY GROUP AVERAGE	6989.5	31	15	16.5	19.3	347	24	1.1	12.5	1.5	0.55	1.34	1.66	1.95	15.5	
(A) DISTRIBUTORS																
INDUSTRY AVERAGE	4382.5	36	124	1.6	20.3	412	21	0.6	15.9	2.3	1.38	1.34	1.83	2.06	10.2	
Genuine Parts GPC	7580.7	43	31	-1.0	15.6	306	20	0.8	16.7	3.2	2.76	2.03	2.24	2.42	6.0	A
WESCO International WCC	1184.2	28	218	4.1	25.1	519	21	0.3	15.1	1.4	0.00	0.65	1.43	1.70	14.4	NR
(B) INTERNET & CATALOG RETAIL																
INDUSTRY AVERAGE	26788.3	49	7	70.9	8.7	502	57	7.5	37.6	1.9	0.00	0.44	1.07	1.29	21.8	
Amazon.com AMZN	16168.2	40	-25	NM	NM	NM	54	2.6	41.6	2.0	0.00	0.08	0.97	1.21	20.0	C
eBay EBAY	72915.6	112	74	143.2	11.7	1197	106	24.4	77.5	2.6	0.00	0.68	1.22	1.59	35.0	NR
IAC/InterActiveCorp IACI	17086.1	25	-27	NM	2.3	118	51	2.7	19.7	1.6	0.00	0.17	0.91	1.03	17.0	B-
Insight Enterprises NSIT	983.3	20	8	-1.5	12.0	192	16	0.3	11.5	1.2	0.00	0.81	1.17	1.34	15.0	B
(C) MULTILINE RETAIL																
INDUSTRY AVERAGE	8183.8	33	10	4.1	14.7	235	22	0.7	9.6	2.0	0.82	2.02	1.74	2.10	17.5	
Big Lots BLI (1)	1302.9	12	-18	-1.8	6.7	128	20	0.3	7.8	1.8	0.00	0.78	0.43	0.68	15.0	B-
Dillard's DDS (1)	2115.8	25	53	-48.4	2.7	96	35	0.3	6.0	6.2	0.64	0.11	0.82	0.93	5.0	B+
Dollar General DG (1)	6485.9	20	-6	10.2	19.9	411	21	0.9	13.8	1.3	0.81	0.89	1.03	1.19	15.0	A+
Dollar Tree Stores DLTR (1)	3156.4	28	-7	11.3	16.4	293	18	1.0	10.7	1.0	0.00	1.54	1.64	1.89	17.0	B+
Family Dollar Stores FDO (8)	4904.7	29	-18	11.4c	19.3	361	19	0.9	13.6	1.3	1.16	1.43	1.53*	1.59	15.0	A+
Federated Department Stores FD (1)	9463.9	55	16	-1.0	12.8	171	14	0.6	6.7	1.5	0.99	3.71	3.83	4.56	9.5	B
Fred's FRED (1)	680.8	17	-44	28.4	9.9	221	23	0.5	11.6	1.1	0.46	0.85	0.77	0.93	20.0	A
Kohl's KSS (1)	15746.1	46	3	21.4	14.1	336	24	1.4	16.9	1.1	0.00	1.72	2.16	2.56	19.4	B+
May Department Stores MAY (1)	8210.6	28	-3	-14.8	13.9	196	14	0.6	6.8	1.9	3.45	1.41	2.09	2.32	7.0	B+
Neiman Marcus Group NM.G (7)	3169.2	65	22	11.4c	14.8	220	15	0.9	10.3	1.5	0.80	2.60	4.19*	4.59	10.1	B
Nordstrom JWN (1)	6122.1	44	28	4.9	19.1	327	17	0.9	9.9	1.3	1.19	1.76	2.71	3.12	12.0	B+
Penney (J.C.) JCP (1)	10306.2	39	47	NA	12.0	217	20	0.6	10.8	1.7	1.30	1.21	2.11	3.01	10.5	B-
Retail Ventures RVI (1)	249.8	7	54	NM	4.7	116	37	0.1	3.8	0.5	0.00	-0.13	0.25	0.61	96.0	C
Saks SKS (1)	1973.3	14	-8	-19.1	2.6	101	41	0.3	7.2	2.9	0.00	0.58	0.60	0.78	8.0	B-
Sears, Roebuck S	10784.8	52	14	32.9	50.2	199	5	0.3	3.0	5.7	1.77	11.86	1.52	2.20	6.0	B+

Investment Outlook Scoreboard

EARNINGS PER SHARE

COMPANY STOCK MARKET	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS PER SHARE 2003	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Target (1)	46268.8	51	33	11.2	15.5	373	24	1.0	14.5	1.6	0.62	2.01	2.14	2.60	15.0	A+
(D) SPECIALTY RETAIL																
INDUSTRY AVERAGE	5488.1	29	13	18.5	21.0	366	22	0.8	11.4	1.3	0.49	1.23	1.68	1.96	14.7	
Abercrombie & Fitch ANF (1)	4362.5	46	84	10.0	26.1	551	21	2.3	15.1	1.2	1.10	2.06	2.47	2.80	15.0	B+
Advance Auto Parts AAP	3033.4	41	1	NM	24.8	398	17	0.8	10.4	1.0	0.00	1.68	2.51	2.94	17.0	NR
American Eagle Outfitters AEOS (1)	3065.3	42	155	-10.3	18.1	374	21	1.7	14.6	1.1	0.57	0.83	2.56	2.88	15.0	B
AnnTaylor Stores ANN (1)	1546.4	22	-16	11.3	11.4	164	15	0.9	9.4	1.1	0.00	1.42	1.33	1.59	15.0	B
Asbury Automotive Group ABG	451.8	14	-23	NA	4.0	97	24	0.1	11.4	0.7	0.00	0.61	1.52	1.69	12.5	NR
AutoNation AN	4897.2	19	1	NM	8.7	119	14	0.3	11.2	1.3	0.00	1.76	1.32	1.49	11.0	B
AutoZone AZO (8)	6816.2	86	0	34.9c	330.4	3977	13	1.2	10.1	0.9	0.00	5.34	6.56*	7.31	14.0	B+
Barnes & Noble BKS (1)	1886.5	27	-18	5.3	12.0	143	13	0.3	5.5	1.0	0.00	2.07	1.98	2.08	13.5	B
Bed Bath & Beyond BBBY (2)	12015.6	40	-8	30.2	20.2	544	27	2.5	22.4	1.2	0.00	1.31	1.60	1.89	20.0	A-
Best Buy BBY (2)	18289.5	56	8	21.6	23.7	508	22	0.7	14.6	1.3	0.78	2.44	2.94	3.41	15.0	B
Blockbuster BBI	1535.7	8	-53	NM	NM	141	NM	0.3	NM	0.6	0.94	-5.44	0.76	0.70	17.5	NR
Borders Group BGP (1)	1734.0	23	4	6.7	12.2	161	14	0.5	7.4	1.3	1.40	1.54	1.69	1.89	10.0	B
Cabela's CAB	1378.3	21	NA	13.8	11.7	262	21	0.9	15.5	1.5	0.00	0.93	0.95	1.06	15.0	NR
CarMax KMX (2)	2898.1	28	-10	226.0	14.2	386	28	0.6	21.8	1.8	0.00	1.10	0.99	1.15	16.0	NR
Charming Shoppes CHRS (1)	1104.7	9	71	-5.4	10.3	159	16	0.5	7.7	1.2	0.00	0.35	0.59	0.67	13.0	B-
Circuit City Stores CC (2)	3042.9	16	54	NM	2.4	145	65	0.3	13.7	2.6	0.45	0.00	0.49	0.69	12.0	B-
CSK Auto CAO (1)	694.6	15	-18	-30.2	5.5	205	38	0.4	15.0	1.1	0.00	0.23	1.14	1.36	12.0	NR
Dick's Sporting Goods DKS (1)	1728.0	36	48	85.3	19.7	642	36	1.0	21.1	1.3	0.00	1.05	1.38	1.81	20.0	NR
Electronics Boutique Holdings ELBO (1)	927.5	39	70	13.2	18.2	314	18	0.5	10.6	1.1	0.00	1.80	2.29	2.49	16.0	NR
Foot Locker FL (1)	4043.9	26	11	36.0	13.6	232	17	0.8	10.6	1.1	1.15	1.40	1.62	1.95	15.0	B-
GameStop GME B (1)	1071.2	21	38	NM	13.1	213	19	0.6	10.7	1.0	0.00	1.06	1.31	1.47	17.0	NR
Gap GPS (1)	19744.2	22	-6	-3.4	21.3	373	19	1.2	11.3	1.2	0.41	1.09	1.25	1.47	15.0	A
Goody's Family Clothing GDYS (1)	319.4	10	4	-2.2	6.6	136	21	0.3	8.4	0.9	1.23	0.53	0.46	0.65	22.5	B-
Group 1 Automotive GPI	679.3	30	-18	20.2	6.6	124	19	0.1	12.9	0.8	0.00	3.26	2.76	3.16	13.5	NR
Guitar Center GTRC	1224.6	48	48	15.9	20.1	440	22	0.9	15.7	1.2	0.00	1.50	2.27	2.60	18.0	NR
Hollywood Entertainment HLYW	772.2	13	-8	NM	21.1	198	10	0.4	2.3	0.6	0.00	1.28	1.31	1.38	15.0	B-
Home Depot HD (1)	91641.3	42	18	16.2	20.7	386	19	1.3	14.8	1.4	0.81	1.88	2.26	2.58	13.0	A+
Jo-Ann Stores JAS (1)	616.3	28	35	NA	10.9	162	15	0.3	7.6	1.1	0.00	1.86	2.06	2.27	12.5	B-
Limited Brands LTD (1)	9933.1	24	36	8.9	15.9	223	17	1.1	9.8	1.2	1.96	1.36	1.41	1.62	14.0	B
Linens 'n Things LIN	1122.0	25	-17	6.4	8.1	142	17	0.4	9.1	1.2	0.00	1.67	1.39	1.86	14.5	B+
Lithia Motors LAD	477.6	25	1	6.4	10.8	121	11	0.2	8.8	1.2	1.26	1.92	2.18	2.41	10.0	NR
Lowe's LOW (1)	42714.8	55	0	28.8	18.8	385	21	1.2	14.6	1.1	0.29	2.32	2.71	3.35	18.0	A+
Men's Wearhouse MW (1)	1133.5	32	27	-0.9	11.8	208	18	0.8	10.0	1.1	0.00	1.27	1.92	2.22	15.0	B+
Michaels Stores MIK (1)	3692.1	27	24	25.4	16.2	309	20	1.1	13.2	1.1	1.02	1.27	1.47	1.71	17.0	B
Office Depot ODP	5126.4	16	-2	8.0	10.8	166	16	0.4	8.5	1.5	0.00	0.96	1.10	1.23	10.0	B+
OfficeMax OMX	2668.4	30	-8	-61.7	6.7	114	16	0.2	4.7	NA	1.98	0.07	1.36	1.96	NA	B-
O'Reilly Automotive ORLY	2403.8	44	13	18.6	13.1	269	21	1.4	14.8	1.1	0.00	1.84	2.17	2.57	18.0	B+
Pantry PTRY (9)	553.8	28	21	4.0b	11.5	364	32	0.2	7.5	2.4	0.00	0.82	0.85*	1.96	13.5	NR
Payless ShoeSource PSS (1)	795.6	12	-13	NM	1.1	125	117	0.3	7.6	3.9	0.00	0.00	0.49	0.61	6.0	NR
Pep Boys-Manny, Moe & Jack PBY (1)	913.3	16	-31	NM	5.3	121	24	0.4	8.4	1.2	1.71	-0.22	0.76	0.96	17.5	B
Petco Animal Supplies PETC (1)	2080.4	36	19	174.2	69.8	1885	27	1.2	15.2	1.2	0.00	1.11	1.51	1.82	20.0	NR
Petsmart PETM (1)	4970.0	34	44	NM	17.3	529	31	1.5	18.5	1.5	0.35	0.95	1.18	1.43	20.0	B-
Pier 1 Imports PIR (2)	1571.6	18	-17	14.1	15.8	242	16	0.8	10.0	1.2	2.19	1.29	1.05	1.22	14.0	A-
RadioShack RSH	5015.6	32	3	4.2	41.0	617	16	1.1	11.7	1.2	0.79	1.77	2.10	2.39	13.0	B+
Regis RGS (6)-	1980.2	45	13	18.4c	14.8	276	19	1.0	10.8	1.4	0.36	1.92	2.29*	2.57	14.0	A-
Rent-A-Center RCII	1932.2	25	-15	27.4	20.6	249	13	0.8	2.9	1.0	0.00	2.08	2.27	2.33	11.0	B+
Ross Stores ROST (1)	3967.7	27	2	15.9	26.2	539	21	1.0	NA	1.5	0.63	1.47	1.20	1.56	15.0	A+
Sherwin-Williams SHW	6304.1	45	28	6.1	24.3	401	17	1.1	12.9	1.7	1.52	2.26	2.66	3.03	10.0	A
Sonic Automotive SAH	1026.8	25	8	15.2	12.6	136	11	0.1	9.2	0.8	1.93	2.07	2.22	2.57	14.0	NR
Sports Authority TSA (1)	735.4	29	-26	40.3	5.0	160	32	0.3	10.3	1.0	0.00	0.84	1.91	2.31	15.0	NR
Staples SPLS (1)	15878.5	32	17	NA	17.0	404	24	1.1	16.8	1.5	0.63	0.99	1.40	1.64	15.0	B+
Stein Mart SMRT (1)	706.7	17	102	-24.0	12.2	285	23	0.5	NA	0.8	0.00	0.09	0.79	1.03	25.0	B
Talbots TLB (1)	1602.0	29	-7	18.4	17.1	268	16	1.0	9.3	1.1	1.54	1.81	1.71	1.82	15.0	B+
TBC TBCC	593.8	27	3	16.0	11.9	202	18	0.3	10.0	1.8	0.00	1.47	1.62	2.00	9.0	B+
Tiffany TIF (1)	4479.0	31	-32	9.8	13.8	297	22	2.1	14.2	1.4	0.78	1.45	1.44	1.67	15.0	A
TJX TJX (1)	11505.2	24	7	11.5	46.8	742	16	0.8	11.5	1.1	0.76	1.28	1.39	1.59	15.0	A
Toys 'R' Us TOY (1)	4141.5	19	53	-22.6	3.6	97	27	0.4	8.2	2.7	0.00	0.41	0.89	1.07	8.0	B-
Tractor Supply TSCO	1213.9	32	-19	32.5	17.0	344	22	0.7	14.5	1.0	0.00	1.45	1.58	1.94	20.0	B+
Trans World Entertainment TWMC (1)	386.6	11	58	-19.1	9.9	99	11	0.3	5.2	2.1	0.00	0.49	0.70	0.82	7.5	B-
United Airto Group UAG	1323.6	29	-9	NA	10.3	128	12	0.1	9.5	0.8	1.54	2.07	2.19	2.47	15.5	NR
Williams-Sonoma WSM (1)	4265.7	37	5	22.2	19.8	471	24	1.4	14.9	1.3	0.00	1.32	1.61	1.89	18.0	B+
Zale ZLC (7)	1524.2	29	10	6.3c	14.8	215	15	0.7	9.4	1.2	0.00	-0.63	1.99*	2.23	12.0	B

EARNINGS PER SHARE

ESTIMATES FROM ANALYSTS

COMPANY STOCK SYMBOL (FY)	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
CONSUMER STAPLES																
SECTOR AVERAGE	18372.4	36	15	14.1	23.6	2323	22	1.2	14.2	2.0	1.49	0.87	1.89	2.14	9.9	
6 FOOD & STAPLES RETAILING																
INDUSTRY GROUP AVERAGE	16437.0	30	10	7.6	13.4	298	26	0.4	15.0	1.9	0.86	0.94	1.14	1.42	11.4	
Albertson's ABS (1)	9310.4	25	12	12.9	10.5	175	22	0.2	6.4	2.3	3.00	1.51	1.45	1.75	7.5	A
BJ's Wholesale Club BJ (1)	2062.9	30	29	-0.3	13.1	228	18	0.3	9.6	1.8	0.00	1.50	1.68	1.87	10.0	NR
Casey's General Stores CASY (4)	969.6	19	10	-1.6	8.5	214	25	0.4	11.0	NA	0.83	0.73	0.92	1.09	NA	A-
Costco Wholesale COST (8)	22484.2	49	31	8.0c	11.6	295	26	0.5	17.0	2.2	0.82	1.53	1.85*	2.11	12.0	B+
CVS CVS	18142.4	45	26	7.3	13.6	273	20	0.6	13.7	1.6	0.58	2.06	2.14	2.64	13.0	B
Great Atlantic & Pacific Tea GAP (2)	291.2	8	-10	NM	-80.4	98	NM	0.0	11.6	NM	0.00	-5.49	-4.14	-3.89	8.0	C
Kroger KR (1)	11908.5	16	-13	-13.5	4.9	275	58	0.2	8.4	1.7	0.00	0.42	1.20	1.37	8.0	B+
Longs Drug Stores LDG (1)	1003.9	27	8	-18.3	4.5	139	31	0.2	8.6	2.1	2.10	0.79	1.06	1.18	12.0	B+
Nash Finch NAFC	460.5	37	66	20.8	6.2	176	28	0.1	7.9	1.4	1.46	2.85	2.99	3.59	8.7	B
NeighborCare NCRX (9)	1234.9	28	42	NM	-1.7	319	NM	0.9	61.5	NM	0.00	0.03	-0.15*	1.17	NA	NR
Performance Food Group PFGC	1227.3	26	-27	23.5	6.5	142	22	0.2	11.7	1.4	0.00	1.54	1.24	1.60	15.0	B+
Rite Aid RAD (2)	1900.1	4	-39	NM	182.1	NM	11	0.1	4.1	1.7	0.00	0.11	0.19	0.27	11.0	C
Ruddick RDK (9)	1018.1	22	22	6.0c	11.8	185	16	0.4	7.2	2.3	2.02	1.29	1.38*	1.43	7.0	A-
Safeway SWY	8622.0	19	-12	NM	-8.4	214	NM	0.2	15.5	1.8	0.00	-0.38	1.37	1.67	8.0	B
7-Eleven SE	2664.8	24	47	-4.4	24.0	585	26	0.2	NA	1.7	0.00	0.76	0.93	1.09	15.0	B-
Supervalu SVU (2)	4239.6	32	10	2.8	15.7	179	15	0.2	6.3	1.7	1.93	2.07	2.37	2.56	8.0	A-
Sysco SYY (6)	22173.6	35	-7	19.6c	33.5	803	24	0.7	18.3	1.7	1.73	1.18	1.37*	1.51	15.0	A+
United Natural Foods UNFI (7)	1128.9	28	57	NM	14.3	461	33	0.6	24.0	1.8	0.00	0.51	0.78*	0.99	19.5	B+
Walgreen WAG (8)	39069.3	38	5	14.6c	16.5	475	29	1.0	22.2	1.9	0.55	1.14	1.32*	1.49	15.0	A+
Wal-Mart Stores WMT (1)	220865.2	52	-2	NA	21.9	492	23	0.8	15.7	1.5	1.00	2.03	2.40	2.74	14.0	A+
Weis Markets WMK	1039.8	38	6	1.3	9.9	184	19	0.5	10.8	3.6	2.92	2.01	2.14	2.26	5.0	B+
Whole Foods Market WFMI (9)	5664.8	91	35	42.1c	13.9	573	43	1.5	22.8	2.2	0.84	1.66	2.09*	2.40	19.5	B
Winn-Dixie Stores WIN (6)	568.1	4	-60	NM	-23.4	74	NM	0.1	NM	NM	0.00	1.68	-0.36*	-0.29	8.0	B
7 FOOD, BEVERAGE, & TOBACCO																
INDUSTRY GROUP AVERAGE	16910.5	38	19	18.2	23.3	3863	19	1.4	13.0	2.0	1.93	0.66	2.32	2.54	8.9	
(A) BEVERAGES																
INDUSTRY AVERAGE	27993.1	42	10	26.3	26.5	484	18	1.8	11.5	1.9	1.38	2.15	2.34	2.57	9.8	
Anheuser-Busch BUD	39574.5	50	-5	13.9	79.6	1431	18	2.7	12.7	1.8	1.96	2.48	2.74	2.97	10.0	A+
Brown-Forman BF.B (4)	5848.1	48	3	7.5	24.3	486	20	2.6	16.7	2.5	2.04	2.11	2.44	2.67	8.0	A
Coca-Cola KO	94980.0	39	-23	15.9	30.6	635	21	4.3	17.5	2.0	2.54	1.77	1.99	2.03	10.0	B+
Coca-Cola Enterprises CCE	9758.0	21	-5	83.7	12.6	192	15	0.5	5.7	1.8	0.77	1.46	1.28	1.41	9.0	B+
Constellation Brands STZ (2)	4821.5	45	36	18.8	11.2	202	18	1.3	13.6	1.3	0.00	2.06	2.66	2.99	12.5	B+
Coors (Adolph) RKY	2803.2	75	34	17.7	11.7	185	16	0.7	6.4	1.7	1.09	4.77	4.71	5.28	9.5	A
Pepsi Bottling Group PBG	7033.0	28	16	35.7	24.3	378	16	0.7	6.8	1.6	0.71	1.52	1.73	1.89	10.0	NR
PepsiAmericas PAS	2921.6	21	23	33.1	11.7	187	16	0.9	8.3	2.1	1.42	1.09	1.21	1.31	8.5	B-
PepsiCo PEP	84198.2	50	7	10.1	32.4	656	21	3.0	15.6	2.0	1.84	2.05	2.31	2.56	11.0	A+
(B) FOOD PRODUCTS																
INDUSTRY AVERAGE	9817.9	35	23	16.4	22.5	401	19	1.2	12.5	2.1	1.58	1.67	1.99	2.15	8.7	
Archer Daniels Midland ADM (6)	13875.7	21	39	14.0c	7.7	176	23	0.4	10.7	4.3	1.42	0.70	0.76*	1.45	6.5	B+
Bunge BG	5809.4	53	60	106.6	15.1	187	13	0.2	NA	1.5	0.91	4.14	4.03	3.91	9.0	NR
Campbell Soup CPB (7)	11640.2	29	6	-1.5c	59.6	1042	18	1.6	12.8	3.0	2.38	1.52	1.57*	1.68	6.0	B+
ConAgra Foods CAG (5)	13911.5	27	3	20.8	16.4	299	19	0.9	NA	2.1	4.03	1.50	1.57	1.69	8.0	A
Corn Products International CPO	1975.9	54	58	1.7	9.9	194	19	0.9	9.7	2.2	0.88	2.11	2.66	2.96	9.5	NR
Dean Foods DF	4761.2	32	-4	24.5	10.6	184	19	0.5	9.8	1.7	0.00	2.27	2.03	2.24	9.0	B+
Del Monte Foods DLM (4)	2276.1	11	4	-1.6	13.5	191	14	0.7	NA	1.5	0.00	0.76	0.89	0.96	8.0	NR
Flowers Foods FLO	1320.1	31	18	NM	10.4	232	23	0.9	11.6	2.1	1.64	1.15	1.33	1.46	11.0	NR
Fresh Del Monte Produce FDP	1584.2	28	15	39.4	13.5	149	11	0.6	7.6	1.5	2.91	3.95	2.03	2.50	9.0	NR
General Mills GIS (5)	17286.2	45	0	8.3	18.8	322	17	1.6	12.1	2.0	2.73	2.75	2.86	3.10	8.0	A-
Gold Kist GKIS (6)	709.1	14	NA	NA	38.2	223	NA	0.3	NA	0.7	0.00	-1.12	2.42*	1.14	8.5	NR
Heinz (H.J.) HNZ (4)	12981.1	37	2	0.1	36.6	599	17	1.5	12.6	2.0	3.07	2.20	2.34	2.50	8.0	B+
Hershey Foods HSY	12746.9	52	35	1.8	60.1	1355	24	2.9	16.9	2.5	1.70	1.76	2.05	2.27	10.0	A-
Hormel Foods HRL (10)	4247.4	31	19	8.4c	16.6	304	19	0.9	13.3	2.0	1.70	1.33	1.65*	1.72	9.5	A
Kellogg K	18030.6	44	15	23.5	47.7	964	20	1.9	14.0	2.3	2.31	1.92	2.14	2.37	9.0	B+
Kraft Foods KFT	58512.5	34	6	13.8	9.9	200	20	1.8	15.6	2.6	2.40	2.01	1.88	1.98	7.0	NR
McCormick MKC (11)	4983.3	36	21	NA	26.6	619	24	2.0	NA	2.5	1.76	1.40	1.56	1.74	9.5	A
Pilgrim's Pride PPC (9)	2229.6	34	105	12.7c	13.9	242	16	0.4	9.3	2.0	0.18	1.36	2.05*	2.69	8.0	B+
Ralcorp RAH (9)	1205.3	41	31	16.4c	14.7	271	19	0.8	20.9	1.9	0.00	0.25	2.17*	2.52	10.0	B-
Sara Lee SLE (6)	18427.4	23	8	5.3c	46.1	610	13	0.9	9.4	2.1	3.36	1.50	1.59*	1.65	7.0	A-
Smithfield Foods SFD (4)	3224.1	29	40	NA	14.1	200	14	0.3	8.4	1.4	0.00	1.46	2.14	2.51	10.0	B
Smucker (J.M.) SJM (4)	2651.2	45	0	23.3	7.2	158	20	1.6	NA	1.9	2.20	2.21	2.61	2.90	9.0	A-
Tyson Foods TSN (9)	5802.1	16	24	-0.5b	9.4	135	15	0.2	6.5	1.6	0.98	0.96	1.13*	1.28	9.0	B
Wrigley (Wm.) Jr. WWY	15437.8	69	22	10.5	24.1	766	32	4.4	24.5	2.8	1.37	1.98	2.22	2.46	11.0	A+

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ESTIMATES FROM ANALYSTS

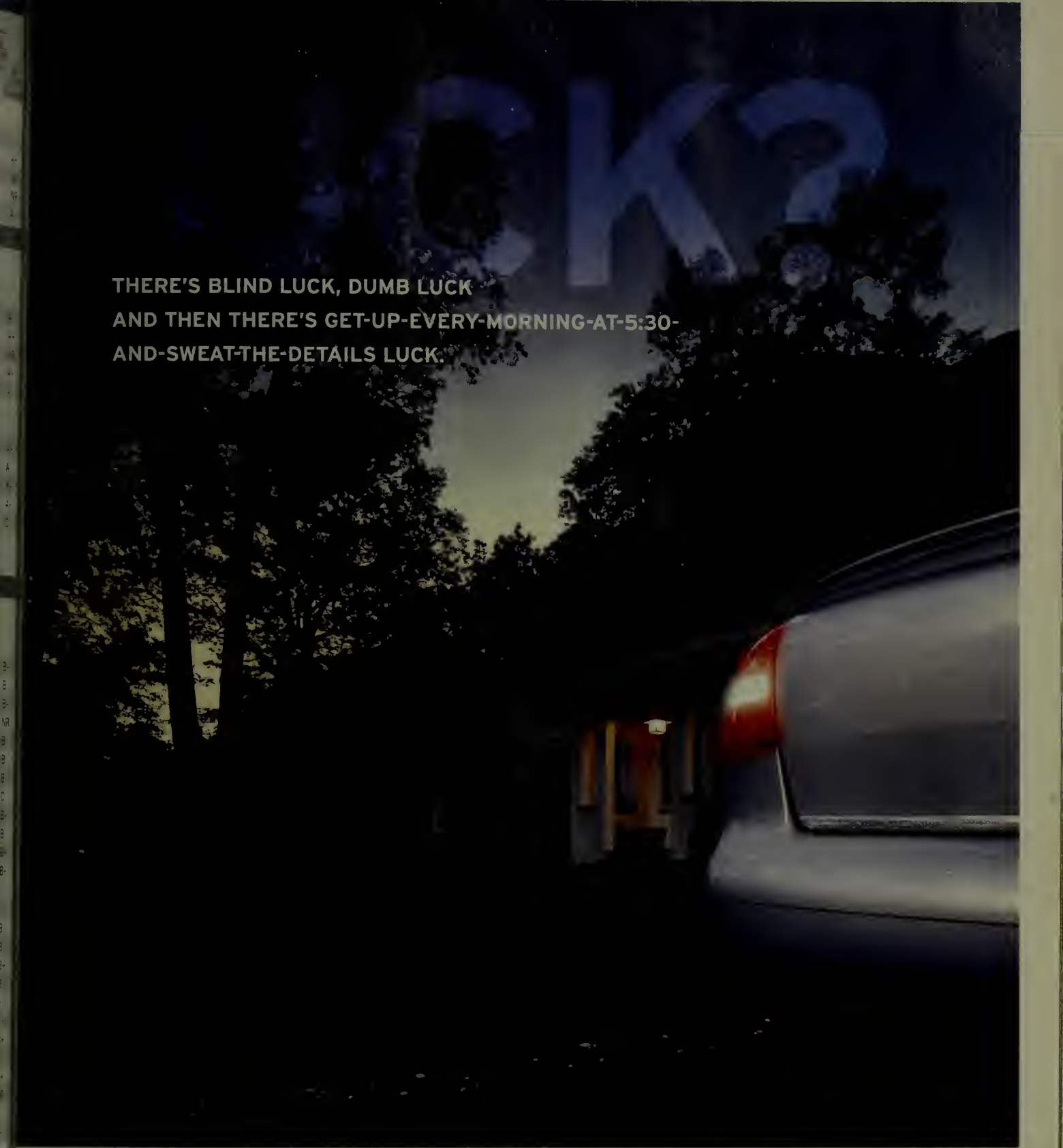
COMPANY	MARKET CAP	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 9-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE- SALES RATIO	PRICE CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST.	2005 CON- SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
INDUSTRY AVERAGE	34530.4	52	19	10.4	17.9	41698	27	2.1	24.0	1.5	5.25	-8.73	4.28	4.78	8.0	
Altria Group INC	117991.6	57	6	9.1	32.9	406	12	1.9	10.6	1.4	5.08	4.52	4.71	5.13	9.0	A+
Cardinal Group INC	1704.2	29	16	NA	NM	NM	10	0.5	NA	1.3	6.19	2.76	2.98	3.13	7.5	NR
Reynolds American RA	11150.4	76	30	NM	2.9	179	67	2.0	37.3	1.5	5.02	-44.08	6.33	7.54	8.0	NR
UST JT	7275.2	44	23	-8.2	NM	124511	20	4.1	NA	1.9	4.72	1.90	3.12	3.32	7.5	A-

8 HOUSEHOLD & PERSONAL PRODUCTS

INDUSTRY GROUP AVERAGE	28232.9	44	9	11.5	50.5	1109	22	2.1	17.0	2.0	1.33	1.47	2.02	2.33	10.3	
(A) HOUSEHOLD PRODUCTS																
INDUSTRY AVERAGE	41311.7	53	9	11.8	48.4	983	19	2.2	14.4	2.0	1.70	2.38	2.82	3.04	9.6	
Clorox CLX (6)	11761.3	55	14	11.0c	32.8	715	22	2.7	16.0	2.4	2.03	2.33	2.55*	2.72	9.1	A
Colgate-Palmolive CL	24387.8	46	-8	13.4	111.3	2512	19	2.4	14.0	1.9	2.09	2.46	2.41	2.61	10.0	A+
Energizer Holdings ENR (9)	3641.5	47	24	15.3c	34.5	470	15	1.3	NA	1.6	0.00	1.93	3.21*	3.39	9.0	NR
Kimberly-Clark KMB	31105.3	64	8	1.8	27.5	471	18	2.1	11.8	2.0	2.52	3.33	3.62	3.91	9.0	A-
Procter & Gamble PG (6)	135662.7	53	7	17.3c	35.9	749	22	2.6	15.9	2.1	1.87	1.85	2.32*	2.59	11.0	A
(B) PERSONAL PRODUCTS																
INDUSTRY AVERAGE	15154.1	35	9	11.1	53.1	1266	26	2.0	19.5	2.1	0.95	0.55	1.22	1.62	10.9	
Alberto-Culver ACV (9)	4199.2	46	10	6.2c	10.8	320	30	1.3	22.5	2.5	0.86	1.20	1.54*	2.40	12.0	A+
Avon Products AVP	17754.6	38	11	26.0	115.5	2504	22	2.4	18.8	1.6	1.49	1.39	1.77	1.98	13.5	A
Estée Lauder EL (6)	9850.4	44	11	7.8c	22.6	567	26	1.7	17.2	2.2	0.92	1.29	1.62*	1.92	12.0	A-
Gillette G	43185.6	43	18	4.3	63.4	1675	27	4.3	19.4	2.2	1.49	1.34	1.67	1.88	12.0	A-
Revlon REV	780.9	2	-6	NM	NM	NM	NM	0.6	NM	NM	0.00	-2.47	-0.49	-0.07	5.0	C

ENERGY

SECTOR AVERAGE	21127.9	47	47	24.0	14.6	283	21	1.6	10.6	2.2	0.94	2.08	3.51	3.49	10.9	
9 ENERGY																
INDUSTRY GROUP AVERAGE	21127.9	47	47	24.0	14.6	283	21	1.6	10.6	2.2	0.94	2.08	3.51	3.49	10.9	
(A) ENERGY EQUIPMENT & SERVICES																
INDUSTRY AVERAGE	10037.2	44	38	19.7	10.1	401	38	2.2	18.5	2.4	0.34	0.79	1.39	1.90	18.7	
Baker Hughes BHI	14855.0	44	38	61.2	12.4	406	33	2.5	NA	2.0	1.04	0.54	1.49	1.84	15.0	B-
BJ Services BJS (9)	8162.6	51	41	31.0c	17.8	415	24	3.1	17.2	1.6	0.63	1.17	2.14*	2.34	15.0	B
Cooper Cameron CAM	2769.4	52	12	6.7	6.0	241	41	1.4	18.3	2.0	0.00	1.04	1.88	2.39	14.0	B-
FMC Technologies FTI	2243.7	33	41	NA	15.2	412	27	0.9	16.5	1.7	0.00	1.13	1.17	1.52	16.5	NR
Halliburton HAL	18276.7	41	59	18.2	20.8	1089	52	0.9	21.3	2.4	1.21	0.78	1.46	1.86	11.7	B
Nabors Industries NBR	7752.8	52	25	51.3	9.3	280	31	3.5	14.2	1.1	0.00	1.25	1.86	2.71	26.0	B
National-Oilwell NOI	3109.7	36	62	NM	6.3	263	39	1.4	25.9	1.3	0.00	0.90	1.06	1.83	25.5	B
Pride International PDE	2660.9	20	5	NM	-3.6	158	NM	1.5	13.2	5.2	0.00	-0.18	0.19	0.60	20.0	C
Schlumberger SLB	38639.2	66	20	10.2	15.0	652	44	3.2	17.3	2.0	1.14	0.81	2.00	2.50	16.5	B-
Smith International SII	6138.5	61	46	20.6	12.0	453	38	1.5	22.9	2.0	0.00	1.24	1.98	2.50	15.5	B
Transocean RIG	12929.6	40	68	-42.0	3.1	174	56	5.1	17.1	6.7	0.00	0.06	0.40	1.33	15.0	B-
Varco International VRC	2908.0	30	44	20.3	7.2	272	38	2.0	19.4	0.8	0.00	0.68	1.08	1.43	34.0	B-
(B) OIL & GAS																
INDUSTRY AVERAGE	25881.1	49	51	26.1	16.6	233	13	1.4	7.4	2.1	1.20	2.63	4.41	4.17	7.5	
Amerada Hess AHC	8143.4	89	67	4.6	15.4	155	11	0.5	4.6	1.4	1.35	5.17	9.00	8.23	7.0	B
Anadarko Petroleum APC	17302.6	70	36	4.0a	15.8	185	12	3.0	5.9	1.1	0.80	4.91	6.87	6.73	9.0	B
Apache APA	17649.0	54	33	9.6a	18.4	233	13	3.6	6.8	1.1	0.59	3.35	5.10	5.50	10.0	B+
Ashland ASH (9)	4199.7	59	34	NA	14.7	155	11	0.5	7.1	0.9	1.86	1.37	5.59*	2.74	11.3	B
Burlington Resources BR	18169.4	46	68	NM	23.4	281	12	3.5	6.9	1.7	0.73	3.15	3.94	3.92	7.0	B
Chesapeake Energy CHK	4854.9	18	33	68.2	12.0	246	15	2.2	5.3	2.4	1.00	1.20	1.50	1.65	5.0	B-
ChevronTexaco CVX	115676.2	55	26	24.1	26.4	270	10	0.9	7.1	1.7	2.93	3.57	5.49	4.70	5.7	B+
ConocoPhillips COP	62804.3	91	39	29.6	16.6	158	10	0.6	6.0	1.7	2.20	6.70	10.97	9.54	5.0	B
Devon Energy DVN	20131.0	41	45	NM	16.2	159	5	2.3	4.7	2.0	0.48	4.00	4.24	4.38	5.0	B+
El Paso EP	6712.3	10	27	NM	-3.2	156	NM	1.1	7.7	8.5	1.53	-1.03	0.25	0.52	5.0	NR
EOG Resources EOG	8885.7	75	63	-2.0	17.7	345	18	4.5	8.5	2.0	0.32	3.66	4.62	5.37	8.0	B
Exxon Mobil XOM	330628.8	51	25	29.3	24.7	346	14	1.3	10.0	2.0	2.11	3.15	3.64	3.41	7.0	A-
Frontier Oil FTO	718.2	27	55	NM	30.7	299	10	0.3	6.8	1.2	0.90	0.12	2.26	2.39	10.2	B-
Giant Industries GI	345.1	28	134	9.2	8.0	160	18	0.2	6.4	0.5	0.00	1.40	2.92	3.07	20.5	B-
Holly HOC	879.6	28	105	25.2	22.8	266	12	0.4	7.7	1.9	1.14	1.44	2.98	2.11	5.0	B+
Kerr-McGee KMG	9424.2	62	34	-34.0a	6.5	192	23	2.0	7.5	2.7	2.89	2.48	4.68	6.55	5.0	B
Marathon Oil MRO	13663.7	39	19	13.0	13.4	178	13	0.3	6.1	1.5	2.84	3.26	3.61	4.04	7.5	B+
Murphy Oil MUR	7849.2	85	31	26.8	17.0	315	19	1.1	10.2	1.3	1.05	3.25	5.21	6.14	12.3	B+
Occidental Petroleum OXY	23766.2	60	43	34.3	22.6	243	11	2.2	6.8	1.9	1.83	4.11	6.44	6.00	5.0	B+
Pioneer Natural Resources PXD	5112.1	35	10	NM	10.2	194	16	3.0	6.1	1.6	0.57	3.33	2.45	2.49	8.8	B
Premcor PCO	3973.6	45	71	NM	16.1	201	12	0.3	9.8	4.5	0.00	1.68	4.99	4.09	2.0	NR
Sunoco SUN	6037.3	83	61	39.7	26.6	347	14	0.3	7.0	1.6	1.45	4.03	7.23	6.29	7.0	B+
Tesoro TSO	2198.9	33	127	17.5	24.4	167	7	0.2	4.7	1.0	0.00	1.17	5.36	3.08	6.5	B-
Unocal UCL	12086.7	46	25	55.5	21.7	250	12	1.7	6.0	2.9	1.74	2.70	3.98	3.95	4.0	B
Valero Energy VLO	11980.8	47	102	115.3	19.9	171	9	0.2	5.8	1.6	0.68	2.55	5.86	4.47	5.0	B
Western Gas Resources WGR	2289.1	31	31	NM	14.3	363	24	0.8	12.7	1.7	0.65	1.13	1.67	1.77	11.0	B



THERE'S BLIND LUCK, DUMB LUCK
AND THEN THERE'S GET-UP-EVERY-MORNING-AT-5:30-
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COMPANY	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE SALES RATIO	PRICE- CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST.	2005 CON- SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Wells Fargo	8720.1	17	70	NA	-2.2	218	NM	0.7	NA	5.7	1.20	-0.03	0.39	0.78	7.5	B-
Wells Fargo Services (1)	469.8	41	21	NM	14.2	263	19	0.1	16.2	NA	0.73	1.96	2.35	2.95	NA	A-
FINANCIALS SECTOR AVERAGE	20696.8	770	11	12.5	16.1	272	14	2.1	12.4	1.4	1.77	48.89	29.70	37.58	11.2	
INDUSTRY GROUP COMPOSITE	25673.4	49	8	11.8	16.1	240	14	3.3	12.3	1.4	2.64	3.24	3.54	3.85	10.4	
(A) COMMERCIAL BANKS																
INDUSTRY AVERAGE	26509.5	46	8	10.1	15.9	252	15	3.4	13.3	1.5	2.95	2.82	3.16	3.44	10.0	
AmSouth Bancorporation ASO	9195.7	26	6	19.8	17.5	266	15	3.1	12.8	1.7	3.86	1.77	1.89	2.03	8.0	A-
Bank of America BAC	187350.1	46	15	12.4	13.3	192	13	3.2	12.9	1.3	3.89	3.57	3.70	4.03	10.0	A-
Banknorth Group BNK	6259.6	36	11	12.7	12.3	205	16	4.0	14.6	1.6	2.22	2.15	2.29	2.54	10.0	A-
BB&T BBT	23453.1	42	10	4.7	13.4	217	16	3.6	13.7	1.5	3.30	2.07	2.82	3.15	10.0	A-
Comerica CMA	10489.8	62	10	-2.6	14.1	208	15	3.4	NA	1.8	3.38	3.75	4.27	4.55	8.0	A
Commerce Bancorp CBH	4937.5	62	19	24.7	16.5	319	20	3.3	NA	1.1	1.22	2.61	3.24	3.81	18.0	A+
Compass Bancshares CBSS	5716.4	47	18	10.5	18.0	288	16	3.1	12.3	1.6	2.68	2.69	2.93	3.21	10.0	A+
Fifth Third Bancorp FITB	28257.6	50	-15	15.9	19.4	313	16	4.3	NA	1.3	2.54	2.97	3.19	3.50	12.5	A+
First Horizon National FHN	5380.7	44	-1	18.4	23.7	271	12	2.1	7.6	1.2	3.94	3.62	3.61	3.82	10.0	A+
Hibernia HIB	4484.4	29	23	11.8	15.2	237	16	3.4	13.9	1.7	2.77	1.64	1.87	2.06	9.0	A-
Huntington Bancshares HBAN	5583.5	24	8	0.8	16.3	227	14	2.5	7.2	1.7	3.30	1.67	1.76	1.86	8.0	B+
KeyCorp KEY	13506.5	33	14	-3.6	14.0	194	14	2.4	NA	1.9	3.72	2.12	2.40	2.55	7.5	A-
M&T Bank MTB	12245.1	105	7	11.9	12.2	214	18	3.9	13.6	1.8	1.52	4.95	5.98	6.69	10.0	A+
Marshall & Ilsley MI	9300.3	42	9	9.8	16.6	259	16	3.2	NA	1.5	2.01	2.38	2.70	2.99	10.0	A
National City NCC	24408.8	37	9	11.4	18.9	195	10	2.5	7.9	1.3	3.78	3.43	3.51	3.23	8.0	A
North Fork Bancorporation NFB	13554.6	29	7	14.5	17.6	550	11	10.2	29.2	1.6	3.06	1.73	1.85	2.33	10.0	A-
PNC Financial Services Group PNC	15395.2	54	-1	-1.9	16.3	211	13	2.5	NA	1.6	3.68	3.65	4.18	4.33	8.0	B+
Popular BPOP	7058.1	27	18	17.2	15.1	250	15	2.6	12.9	1.3	2.42	1.74	1.79	2.02	11.2	A+
Regions Financial RF	16227.2	35	16	5.4	7.0	152	15	3.9	19.7	2.0	3.81	2.35	2.36	2.63	7.5	A-
SunTrust Banks STI	20178.0	71	0	7.9	14.4	199	14	2.8	NA	1.5	2.81	4.73	5.20	5.49	9.0	A+
Synovus Financial SNV	8357.5	27	-7	12.7	16.3	324	20	3.2	NA	1.5	2.57	1.28	1.41	1.61	12.5	A+
U.S. Bancorp USB	55433.0	30	-1	13.4	20.8	283	14	3.8	NA	1.4	3.24	1.92	2.19	2.42	10.0	NR
UnionBanCal UB	9099.1	62	7	10.4	17.1	221	13	3.3	NA	1.4	2.33	3.90	4.45	4.79	10.0	A
Wachovia WB	83002.0	52	11	-1.1	14.4	245	14	3.1	13.2	1.3	3.56	3.17	3.94	4.21	10.0	A-
Wells Fargo WFC	104412.2	62	5	12.4	18.7	284	15	3.2	9.8	1.3	3.11	3.65	4.12	4.61	12.0	A
Zions Bancorporation ZION	5961.0	67	8	13.3	14.6	219	15	3.2	11.8	1.4	1.92	3.74	4.47	4.96	11.0	A
(B) THRIFTS & MORTGAGE FINANCE																
INDUSTRY AVERAGE	22568.1	58	8	18.3	16.9	197	12	2.8	9.7	1.0	1.49	4.80	4.97	5.36	11.8	
Countrywide Financial CFC	18771.5	33	31	48.8	25.3	187	8	1.5	4.2	0.7	1.45	4.16	3.94	3.75	12.0	A
Fannie Mae FNM	66501.6	69	-8	19.9	28.8	302	9	1.2	8.8	0.8	3.03	7.72	7.62	7.58	11.0	A+
Golden West Financial GDW	18249.8	119	16	25.7	17.9	265	15	4.4	14.3	1.2	0.40	7.14	8.17	9.09	12.0	A+
MGIC Investment MTG	6660.4	68	19	3.5	12.7	161	13	4.1	12.2	1.0	0.44	4.99	5.47	6.20	12.5	A
Radian Group RDN	4710.5	51	5	1.3	12.0	135	12	3.5	NA	0.8	0.16	4.08	4.71	5.35	13.0	A
Sovereign Bancorp SOV	7539.5	22	-8	9.2	8.9	157	16	2.9	12.9	1.1	0.55	1.38	1.66	1.90	12.0	B+
Washington Mutual WM	35543.3	41	1	19.9	12.6	171	14	2.2	5.9	1.3	4.42	4.12	3.25	3.62	10.0	A
11 DIVERSIFIED FINANCIALS																
INDUSTRY GROUP AVERAGE	32795.4	49	10	5.6	26.0	567	17	2.7	14.6	1.3	1.29	2.75	3.26	3.51	12.7	
(A) CAPITAL MARKETS																
INDUSTRY AVERAGE	20152.3	52	5	0.9	15.5	248	17	2.4	14.1	1.4	1.25	2.91	3.58	3.77	12.4	
Bank of New York BK	25563.9	33	-1	-9.6	15.4	282	18	3.7	13.6	1.5	2.43	1.52	1.89	2.12	12.0	A-
Bear Stearns BSC (11)	9991.8	98	22	22.0	15.5	131	10	1.3	7.1	1.0	1.02	8.52	9.26	8.59	10.5	A
E*Trade Financial ET	5178.4	14	10	NM	17.1	241	15	2.5	NA	1.0	0.00	0.55	0.88	0.97	15.0	B-
Edwards (A.G.) AGE (2)	3007.6	39	8	-16.8	10.5	175	17	1.2	NA	1.4	1.64	1.97	2.26	2.74	12.0	A-
Franklin Resources BEN (9)	16365.6	66	26	5.9c	14.0	320	23	4.8	21.7	1.9	0.52	1.97	2.83*	3.44	12.0	A-
Goldman Sachs Group GS (11)	50692.1	105	6	2.0	18.4	216	12	1.8	9.9	0.9	0.95	5.87	8.77	8.52	13.0	NR
Legg Mason LM (3)	7052.5	68	32	NA	20.3	408	22	3.2	17.6	1.4	0.88	2.64	3.32	3.96	15.0	A
Lehman Brothers Holdings LEH (11)	22579.4	84	8	12.0	15.2	173	11	1.1	8.4	0.9	0.76	6.35	7.62	7.31	12.0	A-
Mellon Financial MEL	12376.1	29	-9	2.5	19.9	313	16	2.6	13.0	1.4	2.46	1.57	1.78	1.97	12.0	A-
Merrill Lynch MER	51760.1	56	-5	5.7	14.8	174	13	2.2	10.3	1.1	1.15	4.05	4.27	4.75	12.0	A-
Morgan Stanley MWD (11)	55657.9	51	-12	-5.0	15.8	203	13	1.5	NA	1.0	1.97	3.45	4.01	4.50	12.5	A-
Northern Trust NTRS	10311.6	47	2	NA	15.6	320	21	3.8	17.3	1.7	1.79	1.89	2.30	2.54	12.0	A-
Raymond James Financial RJF (9)	2171.3	30	18	-0.8c	12.0	204	17	1.2	14.8	1.9	0.95	0.78	1.72*	1.91	9.0	B+
Schwab (Charles) SCH	14579.2	11	-9	-9.4	10.1	320	32	3.2	21.0	1.9	0.74	0.35	0.38	0.51	15.0	A-
State Street STT	14996.7	45	-14	3.1	17.2	244	14	2.7	NA	1.4	1.44	2.15	2.48	2.75	12.5	A
(B) CONSUMER FINANCE																
INDUSTRY AVERAGE	25247.1	42	18	10.7	23.4	379	17	2.7	15.3	1.3	0.75	2.33	2.58	2.89	13.8	
American Express AXP	69916.0	56	16	6.1	21.4	441	21	2.4	NA	1.5	0.86	2.31	2.73	3.09	13.5	A-
Capital One Financial COF	19072.7	79	28	29.2	20.4	241	12	1.8	NA	0.8	0.14	4.92	6.42	6.95	15.0	A+
MBNA KRB	33935.1	27	7	21.3	20.8	272	13	2.8	NA	1.0	1.81	1.79	2.05	2.30	13.0	A+
MoneyGram International MGI	1894.2	21	-14	-0.4	12.4	339	27	2.0	19.3	1.8	0.19	1.29	0.92	1.05	13.0	B

Fighting Cancer



Extending Life

Science For A Better Life



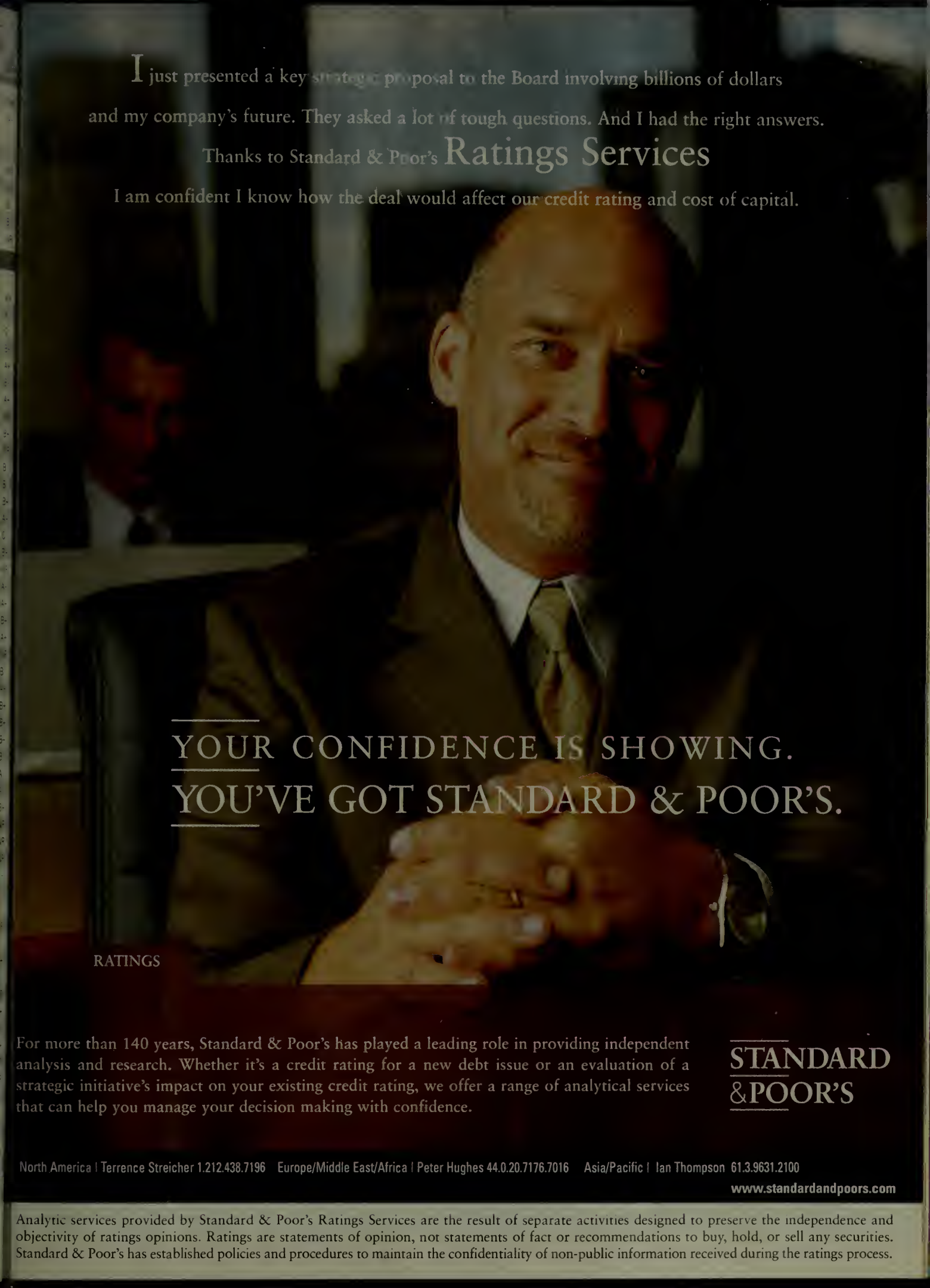
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COMPANY TICKER	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS					LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
												2003 ACTUAL	2004 ANALYST EST	2005 CONSENSUS				
CLOUTIER ED FINANCIAL SERVICES																		
INDUSTRY AVERAGE	79782.7	49	12	11.8	60.9	1752	19	3.4	15.8	1.3	2.05	2.79	3.13	3.47	12.2			
CIT Group CIT	8972.0	43	19	9.9	12.1	154	13	2.0	5.4	1.3	1.22	2.66	3.34	3.88	10.0	NR		
Chigroup C	232241.3	45	-8	14.6	15.9	227	14	2.2	12.6	0.9	3.58	3.42	4.03	4.38	12.0	A+		
JPMorgan Chase JPM	134187.3	38	3	-3.8	4.4	128	19	2.7	16.7	1.1	3.61	3.24	3.02	3.32	11.0	B		
Moody's MCO	11945.2	81	33	26.3	263.1	8098	32	8.5	28.3	1.9	0.37	2.39	2.88	3.11	15.0	B		
Principal Financial Group PFG	11567.8	38	14	NA	8.8	150	17	1.4	NA	1.2	1.46	2.23	2.37	2.69	13.0	NR		
12 INSURANCE																		
INDUSTRY GROUP AVERAGE	12610.3	1571	14	16.4	12.3	149	13	1.2	10.8	1.4	1.47	99.90	58.94	75.26	10.8			
ACE ACE	11483.8	40	-2	28.3	13.7	121	9	0.9	8.8	0.8	2.03	5.01	4.02	5.85	12.0	B+		
AFLAC AFL	19041.7	38	4	9.7	13.2	263	20	1.5	NA	1.1	1.01	1.52	2.28	2.62	15.0	A		
Allmerica Financial AFC	1731.7	33	6	-28.5	5.8	75	13	0.6	10.0	4.8	0.00	1.63	2.25	3.02	3.0	C		
Allstate ALL	34794.5	51	17	3.3	14.2	165	13	1.0	NA	1.2	2.22	3.85	4.39	5.72	10.0	B+		
Ambac Financial Group ABK	8836.3	81	17	NA	14.6	184	13	6.4	NA	0.9	0.61	5.74	6.33	6.94	14.5	A+		
American Financial Group AFG	2319.5	31	19	16.5	22.1	103	4	0.6	3.5	1.3	1.59	4.51	2.79	3.29	9.0	B-		
American International Group AIG	165062.9	63	-4	10.6	13.8	209	15	1.7	12.8	1.0	0.47	3.53	4.39	5.21	14.5	A+		
AmerUs Group AMH	1704.2	44	25	16.1	10.5	109	11	1.1	NA	1.3	0.92	4.05	4.10	4.47	8.0	NR		
Aon AOC	6683.5	21	-12	11.8	14.4	137	10	0.7	NA	1.5	2.84	2.08	1.96	1.88	7.0	B+		
Assurant AIZ	4224.6	30	NA	18.9	5.2	119	25	0.6	NA	1.2	0.93	1.70	2.52	2.91	10.0	NR		
Berkley (W.R.) BER	3815.3	45	30	NM	21.0	193	10	0.9	8.3	0.7	0.62	3.87	4.58	5.46	13.5	B		
Berkshire Hathaway BRK.A	128730.5	83700	-1	50.9	7.9	160	20	1.7	NA	NA	0.00	5309.00	3025.00	3885.00	NA	B		
Chubb CB	14598.8	76	12	5.1	12.0	152	13	1.1	11.6	1.0	2.05	4.46	7.06	7.80	11.0	B+		
Cincinnati Financial CINF	7526.4	45	13	10.7	8.6	124	14	2.1	13.6	1.6	2.46	2.20	2.83	3.09	10.0	A-		
CNA Financial CNA	6683.0	26	8	NM	3.5	82	26	0.6	17.2	1.5	0.00	-6.58	1.96	2.98	9.0	C		
Commerce Group CGI	1969.4	59	50	18.6	18.8	188	10	1.1	NA	1.1	2.22	4.99	5.29	5.48	10.0	B+		
Consec CNO	2869.8	19	-13	NA	5.4	94	12	0.7	4.2	1.6	0.00	15.71	1.49	1.71	7.8	NR		
Everest Re Group RE	4727.5	84	0	24.7	14.8	134	9	1.0	9.0	0.8	0.47	7.74	8.65	12.33	12.0	A-		
Fidelity National Financial FNF	7477.4	43	22	42.0	16.6	163	10	0.9	7.0	0.9	2.33	5.63	4.18	3.71	12.0	A-		
First American FAF	2929.0	33	11	44.0	15.7	123	8	0.4	5.8	0.7	1.82	5.22	4.03	3.34	12.5	B		
Gallagher (Arthur J.) AJG	2832.1	31	-6	12.4	25.4	381	15	1.9	11.8	1.3	3.26	1.57	2.04	2.11	12.0	A+		
Genworth Financial GNW	12876.5	26	NA	NA	8.3	106	13	1.1	NA	1.1	0.99	1.98	2.17	2.36	11.3	NR		
Hartford Financial Services Group HIG	18787.0	64	8	NM	14.4	138	10	0.9	NA	0.9	1.81	-0.33	6.22	7.33	12.0	B		
Jefferson-Pilot JP	6715.5	49	-3	4.0	13.9	175	13	1.7	NA	1.4	3.09	3.44	3.81	4.10	9.0	A+		
LandAmerica Financial Group LFG	949.5	53	2	34.3	12.6	85	7	0.3	5.0	NA	1.12	10.31	7.89	5.97	NA	B+		
Lincoln National LNC	8032.5	46	14	16.8	16.6	135	8	1.4	6.9	1.0	3.17	4.27	3.94	4.16	12.0	B+		
Loews LTR	12968.2	70	41	NM	9.6	113	14	0.9	NA	NA	0.86	-4.21	5.85	7.09	NA	B-		
Markel MKL	3170.7	322	27	14.6	10.6	211	20	1.4	NA	1.3	0.00	12.52	16.89	25.33	15.0	B-		
Marsh & McLennan MMC	15041.2	29	-40	20.3	21.8	266	12	1.2	9.0	1.3	4.76	2.81	2.01	1.97	11.0	A		
MBIA MBI	8596.2	60	1	27.4	12.1	132	11	4.6	10.7	1.0	1.60	5.61	5.25	5.79	12.0	A		
Mercury General MCY	3089.9	57	22	8.5	18.6	220	12	1.2	11.1	1.2	2.61	3.38	4.80	4.80	10.0	B+		
MetLife MET	29036.4	39	16	22.3a	11.8	126	11	0.8	NA	1.1	1.18	2.57	3.31	3.58	11.0	NR		
Nationwide Financial Services NFS	5715.9	38	14	-8.1a	9.1	111	12	1.4	8.9	1.0	1.92	2.61	3.43	3.55	11.3	NR		
Odyssey Re Holdings ORH	1564.4	24	7	28.8	13.1	112	9	0.6	8.5	1.4	0.52	3.83	1.73	2.66	10.0	NR		
Ohio Casualty OCAS	1327.9	21	24	-7.8	8.0	106	14	0.8	10.9	1.3	0.00	1.24	1.64	2.08	10.0	B-		
Old Republic International ORI	4556.6	25	-1	21.3	11.8	120	10	1.3	NA	1.1	2.08	2.51	2.35	2.65	10.0	A		
PartnerRe PRE	3247.0	61	5	54.6	15.4	116	8	0.8	7.2	0.8	2.22	8.13	6.98	7.87	11.0	B		
Phoenix PNX	1156.3	12	1	NM	3.3	57	18	0.4	NA	1.6	1.31	-0.04	0.72	0.82	10.5	NR		
PMA Capital PMACA	315.2	10	94	NM	-1.7	69	NM	0.4	NA	10.8	0.00	-2.99	0.12	0.52	7.5	C		
Progressive PGR	19744.8	91	9	43.9	26.0	322	13	1.5	11.7	1.3	0.13	5.69	7.09	6.65	10.0	B+		
Protective Life PL	2905.9	42	24	11.4	12.3	137	11	1.5	10.5	1.3	1.67	3.07	3.31	3.55	10.0	A		
Prudential Financial PRU	25236.7	49	17	NA	10.8	117	13	0.9	NA	1.2	1.28	2.06	3.41	4.33	12.5	NR		
Reinsurance Group of America RGA	2894.9	46	20	31.5	11.8	137	11	0.7	NA	1.2	0.78	3.46	3.62	4.01	11.1	B+		
Safeco SAFC	6146.0	48	25	8.1	16.3	165	11	0.9	9.1	1.0	1.82	2.44	4.22	5.12	11.0	B-		
Selective Insurance Group SIGI	1243.9	45	38	6.2	13.0	149	13	0.8	10.0	1.2	1.70	2.40	3.40	3.74	11.0	B+		
St. Paul Travelers STA	24412.4	36	-7	3.4	5.5	118	14	1.2	16.0	1.6	2.41	3.88	2.22	4.73	10.0	NR		
StanCorp Financial Group SFG	2248.3	79	26	32.9	13.9	162	12	1.1	NA	1.1	1.27	5.33	6.44	6.55	11.0	NR		
Stewart Information Services STC	790.2	44	8	37.1	12.1	116	10	0.4	7.0	1.2	1.05	6.88	4.46	3.73	8.0	B		
Torchmark TMK	5960.2	55	21	17.8	14.1	178	13	1.9	NA	1.3	0.80	3.73	4.25	4.68	10.0	A		
Transatlantic Holdings TRH	3837.7	58	-10	12.6	9.7	155	16	1.0	16.0	1.6	0.69	4.60	3.75	5.89	10.0	A-		
21st Century Insurance Group TW	1109.5	13	-6	-10.9	11.2	147	13	0.8	9.8	NA	0.62	0.63	0.90	0.93	NA	B-		
UICI UCI	1517.3	33	152	11.0	21.0	224	11	0.7	8.9	NA	1.50	1.82	2.87	2.79	NA	B-		
Unitrin UTR	3265.4	48	15	-9.8	10.8	166	16	1.1	15.5	1.2	3.48	1.82	2.42	2.88	17.0	B		
UnumProvident UNM	4616.4	16	-1	NM	-7.7	67	NM	0.4	32.1	1.0	1.93	-0.96	1.65	1.78	9.5	B		
XL Capital XL	10446.6	75	-3	-7.4	7.1	142	20	1.1	18.1	1.0	2.60	2.69	6.74	10.21	11.0	B-		



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EARNINGS PER SHARE

ESTIMATES FROM ANALYSTS

COMPANY	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P/E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
INDUSTRY GROUP AVERAGE	3678.0	21	27	NM	-6.1	335	NM	1.2	31.9	1.1	1.85	-0.80	0.62	0.94	14.5	
CB Richard Ellis Group Inc.	1901.6	27	NA	NA	-2.5	398	NM	0.9	31.9	1.1	3.69	-0.68	1.55	1.78	16.5	NR
Eastman Kodak Co.	5454.4	16	27	NM	-9.7	273	NM	1.5	NA	NM	0.00	-0.92	-0.31	0.10	12.5	C
HEALTH CARE SECTOR AVERAGE	17117.6	42	8	23.3	18.4	386	25	2.5	18.3	1.9	0.56	1.71	2.15	2.46	14.5	
HEALTH-CARE EQUIPMENT & SERVICES																
INDUSTRY GROUP AVERAGE	8614.1	44	15	26.8	19.7	373	22	1.7	14.8	1.4	0.34	2.03	2.35	2.65	14.6	
(A) HEALTH-CARE EQUIPMENT & SUPPLIES																
INDUSTRY AVERAGE	12442.4	49	19	24.6	16.3	455	30	3.4	21.4	1.7	0.57	1.59	2.05	2.41	15.1	
Bard (C.R.) BCR	6265.9	60	47	9.0	19.9	493	25	3.9	20.3	1.9	0.80	1.60	2.42	2.76	13.0	B+
Bausch & Lomb BOL	3148.3	59	13	7.5	12.0	241	20	1.4	11.2	1.4	0.88	2.36	2.90	3.34	15.0	B-
Baxter International BAX	19492.5	32	4	2.6	17.8	529	30	2.1	15.6	1.9	1.84	1.52	1.68	1.89	10.0	B+
Beckman Coulter BEC	3980.0	65	29	16.3	22.8	409	19	1.7	NA	1.5	0.79	3.21	3.15	3.62	14.0	B+
Becton, Dickinson BDx (9)	13725.0	55	33	18.4b	18.9	451	25	2.8	NA	2.1	1.31	2.10	2.21*	2.77	12.0	A
Biomet BMET (5)	12117.9	48	32	17.8	22.1	865	40	7.2	32.6	1.9	0.42	1.27	1.57	1.81	16.0	A-
Boston Scientific BSX	29396.2	35	-5	5.0	22.5	734	33	5.9	NA	1.1	0.00	0.56	1.62	2.19	20.0	B
Dade Behring Holdings DADE	2317.2	54	50	NA	8.7	294	35	1.5	10.6	1.8	0.00	1.19	1.69	2.07	17.5	NR
Dentsply International XRAY	4235.1	53	16	18.1	14.5	323	23	2.6	18.5	1.5	0.46	2.11	2.35	2.63	15.0	A-
Fisher Scientific International FSH	6612.9	57	37	23.7	2.8	171	41	1.5	29.2	1.3	0.00	1.29	2.84	3.60	15.0	B-
Guidant GDT	20602.3	65	8	4.4	18.8	598	32	5.5	NA	1.8	0.62	1.36	2.42	2.61	15.0	B
Hillbrand Industries HB (9)	3401.2	55	-11	12.1b	17.1	309	18	1.9	NA	NA	1.96	2.91	3.00*	3.44	NA	B+
Hospira HSP	5030.2	32	NA	NA	34.4	557	16	1.9	11.0	2.6	0.00	1.65	1.77	1.76	7.0	NR
Invacare IVC	1577.3	51	25	13.7	11.7	234	21	1.2	14.6	1.7	0.10	2.25	2.48	3.05	12.0	B+
Medtronic MDT (4)	58114.6	48	-1	15.3	21.1	586	28	6.1	23.3	1.7	0.70	1.60	1.87	2.18	15.0	A-
PerkinElmer PKI	2732.2	21	25	11.0	6.3	197	31	1.7	16.5	1.4	1.31	0.43	0.88	1.07	17.5	B
St. Jude Medical STJ	13565.1	38	24	89.1	18.3	658	37	6.2	29.5	1.9	0.00	0.92	1.15	1.38	17.0	B
Stryker SYK	17684.0	44	3	118.5	17.5	707	41	4.3	30.2	1.5	0.16	1.12	1.43	1.72	20.0	B+
Thermo Electron TMO	4832.9	30	20	43.5	7.5	199	28	2.2	NA	1.6	0.00	1.04	1.26	1.46	15.0	B-
Zimmer Holdings ZMH	20016.5	82	16	16.1	10.4	551	53	6.9	36.1	1.8	0.00	1.38	2.33	2.83	19.9	NR
(B) HEALTH-CARE PROVIDERS & SERVICES																
INDUSTRY AVERAGE	6833.5	42	13	28.1	21.3	335	18	0.9	12.5	1.2	0.24	2.24	2.49	2.76	14.4	
Accredo Health ACDO (6)	1323.1	27	-14	50.2c	12.2	213	17	0.8	14.8	1.1	0.00	0.61	1.60*	1.60	16.0	NR
Aetna AET	17498.2	119	75	24.3	12.8	193	16	0.9	12.9	1.1	0.03	5.91	7.00	8.44	15.4	NR
Amerigroup AGP	1725.6	69	62	-18.7	15.1	321	22	1.0	16.8	1.4	0.00	2.95	3.30	3.73	15.0	NR
AmerisourceBergen ABC (9)	6627.0	59	5	21.6c	10.8	153	15	0.1	12.2	1.0	0.17	3.89	4.06*	4.14	14.5	A-
Apria Healthcare Group AHG	1486.0	31	8	-13.8	31.2	398	13	1.0	5.6	0.9	0.00	2.15	2.31	1.92	15.0	B-
Beverly Enterprises BEV	936.0	9	1	NM	14.8	358	24	0.5	10.0	1.5	0.00	0.22	0.71	0.77	8.0	C
Cardinal Health CAH (6)	22585.0	52	-15	21.5c	17.3	275	16	0.3	NA	1.0	0.23	3.05	3.47*	3.49	15.0	A+
Caremark Rx CMX	16187.7	36	41	40.5	6.4	218	28	0.8	28.0	1.2	0.00	1.10	1.44	1.90	20.0	B-
Cigna CI	9400.3	70	22	5.3	29.2	204	7	0.5	6.0	1.0	0.14	4.41	6.72	6.13	10.0	B+
Community Health Systems CYH	2410.6	28	4	NM	12.9	203	19	0.7	7.8	1.0	0.00	1.30	1.56	1.87	17.0	NR
Coventry Health Care CVH	4455.2	50	15	54.9	28.5	404	14	0.9	13.4	0.9	0.00	2.75	3.67	4.20	15.0	B-
D&K Healthcare Resources DKHR (6)	102.0	7	-46	-6.9c	3.8	58	15	0.0	9.0	0.9	0.83	0.95	0.71*	0.23	12.0	B
DaVita DVA	3245.9	33	28	NM	50.5	718	15	1.5	10.4	1.2	0.00	1.66	2.11	2.30	13.5	NR
Express Scripts ESRX	5467.8	72	8	10.2	20.8	430	21	0.4	16.6	1.0	0.00	3.17	3.87	4.57	19.0	B+
Genesis HealthCare GHCI (9)	645.0	32	42	NA	5.7	113	20	0.4	8.2	1.2	0.00	NA	1.63*	1.83	16.3	NR
HCA HCA	19034.3	39	-8	24.1	19.0	292	16	0.8	7.7	1.4	1.32	2.61	2.37	2.78	12.0	B
Health Management Associates HMA (9)	5376.3	22	-8	18.0c	16.4	272	17	1.7	11.7	1.1	0.72	1.13	1.32*	1.48	15.0	B+
Health Net HNT	3022.3	27	-17	23.2	16.1	223	14	0.3	11.6	1.3	0.00	2.73	1.94	2.44	10.5	B-
Humana HUM	3955.6	25	9	NM	14.8	196	13	0.3	9.6	1.2	0.00	1.41	1.66	1.92	13.0	B
IMS Health RX	5235.2	23	-9	-7.5	141.7	2652	19	3.5	14.3	1.5	0.35	0.56	1.18	1.33	12.5	NR
Kindred Healthcare KND	1012.7	27	5	NM	11.0	148	15	0.3	6.2	1.2	0.00	1.41	1.79	2.12	12.5	NR
Laboratory Corp. of America Holdings LH	6624.9	48	30	65.1	18.0	335	19	2.2	13.4	1.4	0.00	2.22	2.58	2.84	13.5	B-
Magellan Health Services MGLN	1260.9	36	NA	126.8	117.6	268	3	0.7	2.1	0.9	0.00	10.86	2.55	2.48	15.0	NR
Manor Care HCR	2981.0	34	0	NM	16.3	307	19	0.9	10.4	1.2	1.63	1.31	1.86	2.11	15.0	NR
McKesson MCK (3)	8684.7	30	-8	35.1	10.6	157	15	0.1	12.1	1.1	0.81	2.19	1.99	2.27	14.0	B
Medco Health Solutions MHS	10268.3	38	11	29.6	8.5	186	22	0.3	12.3	1.2	0.00	1.57	2.13	2.37	15.0	NR
Omnicare OCR	3376.3	32	-20	33.0	12.9	180	14	0.8	12.2	0.9	0.28	1.93	2.31	2.55	15.0	A-
Owens & Minor OMI	1093.8	28	27	15.3	13.2	244	19	0.2	14.7	1.3	1.59	1.42	1.55	1.68	13.5	B+
PacificCare Health Systems PHS	4076.7	48	43	1.0	12.7	198	17	0.3	12.3	1.1	0.00	3.04	3.18	3.72	13.5	B
Patterson Companies PDCO (4)	5605.7	41	28	23.0	18.7	621	33	2.5	28.9	1.6	0.00	1.09	1.35	1.62	19.0	B+
Priority Healthcare PHCC	912.6	21	-13	23.1	13.2	236	18	0.5	16.1	1.2	0.00	1.15	1.14	1.21	15.0	NR
PSS World Medical PSSI (3)	803.0	13	4	37.6	12.4	328	28	0.6	17.0	1.5	0.00	0.42	0.52	0.68	16.0	NR
Quest Diagnostics DGX	9472.2	94	28	NM	19.4	382	20	1.9	14.6	1.3	0.64	4.12	4.85	5.47	15.0	NR
Schein (Henry) HSIC	2827.2	65	-4	26.6	12.7	267	22	0.7	15.9	1.4	0.00	3.10	3.05	4.00	15.0	B
Select Medical SEM	1777.4	17	7	NM	22.9	369	17	1.1	11.7	1.1	0.69	0.72	1.06	1.23	15.0	NR
Service Corp. International SCI	2348.6	7	31	NA	7.0	125	17	1.2	8.6	2.9	0.00	0.28	0.33	0.35	7.5	C

CONGRATULATIONS

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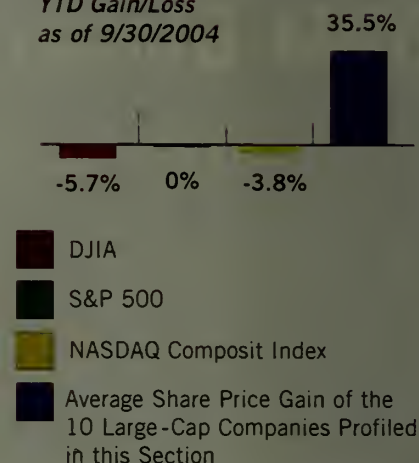


THE EQUITY INVESTOR'S LARGE-CAP REVIEW

SELECTED PROFILES OF THE NATION'S TOP PRICE-PERFORMING LARGE-CAP COMPANIES AS OF 9/30/04

From the approximate 1,800 domestic companies with market capitalizations of more than one billion dollars, the following pages highlight selected top-ranking firms, in terms of YTD share price performance as of 9/30/04. Each profile describes a leading company including its industry, market trends and reasons for success, as written by company management. While past performance is never a guarantee of future results, these top-performing companies represent investment opportunities worthy of a large-cap investor's close consideration.

YTD Gain/Loss
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THE EQUITY INVESTOR'S LARGE-CAP REVIEW

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Key Manager Statement

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As a leading global provider of discovery and development services for pharmaceutical, biotechnology and medical device companies, PPD applies innovative technologies, therapeutic

expertise and commitment to quality to help clients maximize return on their R&D investments. With more than 6,600 professionals in 27 countries, PPD is among the largest providers of preclinical services, Phase I-IV clinical and lab services, and other businesses focused on efficiently delivering new products to market. The company also offers innovative risk-sharing opportunities that help pharmaceutical and biotechnology companies evaluate the development potential for early stage drug compounds in exchange for future royalty and milestone payments.

Key Manager Statement

"With \$1.2 billion in backlog, 20 consecutive quarters of backlog growth and industry-leading margins, PPD remains focused on solid execution and commitment to quality. Our robust cash flow and solid balance sheet provide the strategic flexibility to invest in innovative approaches for drug development, and our compound partnering initiatives offer the opportunity to enhance long-term shareholder value."

Fred Eshelman, CEO

Questar Corp. • STR • Energy/Natural Gas

Salt Lake City, UT • IR Contact: Martin Craven • 801-324-5647
www.questar.com



Questar Corp. offers investors a lower-risk way to invest in the strong fundamentals of natural gas. Nonregulated exploration and production and gas-gathering subsidiaries offer the potential for higher earnings growth and share-price appreciation than typical utilities.

The company has increased gas-equivalent production and proved reserves at 10-year compound average growth rates of 9.1% and 17.8%, respectively.

Questar's regulated subsidiaries — interstate gas transmission and storage and retail gas distribution — provide earnings stability and reduced exposure to volatile commodity prices. From 1998 to 2003, Questar had a compound annual return to shareholders of 16.1% compared to -0.6% for the S&P 500.

Key Manager Statement

"Our primary business objective is to create superior long-term value for our shareholders. We think and act like owners. We serve our customers well, use capital wisely, operate efficiently and safely, develop new opportunities, and find ways to improve performance."

Keith O. Rattie, Chairman, President & CEO

DRS Technologies, Inc. • DRS • Defense/Aerospace

Parsippany, NJ • IR Contact: Patricia M. Williamson • 973-898-6025
p.williamson@drs.com • www.drs.com



DRS Technologies provides leading edge products and services to defense, government intelligence and industrial customers. Focused on defense technology, DRS develops and manufactures a broad range of mission critical systems that uniquely positions the company to support the military's near-term force modernization. With a compound annual revenue growth rate of over 30% for the past five years, DRS has been recognized as one of the fastest growing defense technology companies in the world. With the nation's defense posture moving toward a more highly trained, flexible and mobile deployed force characterized by improved information, communications and networked systems capability, as well as space-based and remote defense capabilities, DRS is in a strong position to successfully execute its strategies this fiscal year.

Key Manager Statement

"DRS expects to benefit from the long-term effects of the sizable, multi-year contracts competitively awarded year to date. We are confident in our ability to achieve our goals and turn in another record fiscal year."

Mark S. Newman, Chairman, President & CEO

Plantronics, Inc. Communications • PLT • Communication

Santa Cruz, CA • IR Contact: Jon Alvarado • 831-458-7533
www.plantronics.com



Plantronics invented the lightweight communication headset in 1961 and is the leading global brand serving this rapidly growing market. Plantronics supplies headsets for mission-critical applications, including Neil Armstrong's first words from the moon, and for the business critical needs of many Fortune 500 corporations. The company serves a broad range of established and emerging markets, including contact center, office, mobile, computer and gaming. Plantronics also delivers a variety of leading edge technologies to extend the frontiers of personal communications, including Bluetooth®, wireless and VoIP. The company has offices in over 20 countries, with 4,400 employees.

Key Manager Statement

"We are excited about the growing adoption of Plantronics' headsets which enabled us to grow sales 42% and earnings per share 76% in fiscal 2004. Our strong financial position, continued cash generation and the absence of any long-term debt positions us to capture the accelerating opportunities in our market."

Ken Kannappan, CEO

MGI PHARMA, INC. • MOGN • Biopharmaceuticals

Minneapolis, MN • IR Contact: Jennifer M. Davis • ir@mgipharma.com
www.mgipharma.com



PHARMA

MGI PHARMA, INC. is an oncology-focused biopharmaceutical company that acquires, develops, and commercializes products that address patient needs. MGI PHARMA markets 4 products to oncologists in the United States, including Aloxi® injection, which was the first drug in its class to be approved for the prevention of both acute and delayed chemotherapy induced nausea and vomiting (CINV). In its first 12 months on the market, U.S. sales of Aloxi injection have exceeded \$100 million. MGI PHARMA has expanded its pipeline of product candidates with the completion of four business development transactions in 2004, and is developing a portfolio of products to continue to advance patient care.

Key Manager Statement

"We have made great progress toward realizing our vision of becoming a leading biopharmaceutical company, and believe that our full-scale oncology commercial organization, proven drug development skills, and commitment to capitalize on our opportunities position us well for future growth."

Lonnie Moulder, President & CEO

ESTIMATES FROM ANALYSTS

COMPANY	MARKET VALUE	RECENT SHARE PRICE	2004					ESTIMATES FROM FIRST					LONG-TERM			
			PRICE CHANGE %	EARNINGS GROWTH %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P/E RATIO	PRICE SALES RATIO	PRICE CASH FLOW RATIO	P/E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	GROWTH RATE %	S&P EQUITY RANKING
Sierra Health Services	1468.3	56	103	83.2	65.3	804	16	0.9	10.8	1.0	0.00	2.70	3.51	3.27	16.3	B-
Tenet Healthcare	5063.3	11	-32	NM	-33.5	132	NM	0.5	NM	NM	0.00	-3.01	-0.13	0.11	12.0	C
Triad Hospitals	2820.8	37	10	NM	4.0	125	31	0.6	10.3	1.0	0.00	1.32	2.40	2.75	15.0	NR
Universal Health Services	54183.9	83	42	39.4	21.3	490	23	1.6	20.1	1.2	0.04	2.96	3.93	4.75	17.0	A
Well Choice	2658.6	46	-15	29.2	14.7	219	16	0.7	7.9	1.2	0.70	3.20	2.82	3.21	14.0	B+
WellPoint	4115.4	49	42	NA	14.8	254	17	0.7	14.7	1.2	0.00	2.41	2.90	3.37	14.5	NR
WellPoint A/H	29684.1d	101	35	NA	NA	158d	NA	NA	NA	1.0	0.00	4.96d	6.60	7.62	15.0	NR

15 PHARMACEUTICALS & BIOTECHNOLOGY

INDUSTRY GROUP AVERAGE	40409.9	37	-10	12.3	15.0	422	35	4.6	27.8	3.4	1.14	0.83	1.63	1.92	14.3	
(A) BIOTECHNOLOGY																
INDUSTRY AVERAGE	26330.8	44	7	8.3	10.8	488	40	7.7	28.4	2.1	0.12	-0.15	1.30	1.68	18.4	
Amgen AMGN	76250.8	60	-3	13.1	11.2	385	36	7.6	25.9	1.2	0.00	1.69	2.43	2.84	20.0	B
Applied Biosystems Group ABI (6)	4018.5	21	-1	-1.7c	13.6	311	24	2.3	14.9	2.5	0.83	0.95	0.83*	0.97	10.0	B
Biogen Idec BIIB	19572.8	59	60	NM	-14.8	292	NM	10.2	NA	2.0	0.00	-4.92	1.46	1.71	20.0	C
Chiron CHIR	6080.9	33	-43	13.5	8.2	247	31	3.6	NA	2.9	0.00	1.15	0.84	1.87	13.5	B-
Genentech DNA	50644.3	48	3	NM	10.1	727	74	11.9	48.7	2.1	0.00	0.58	0.83	1.10	28.3	NR
Genzyme General GENZ	12852.6	56	14	NA	9.1	388	43	6.2	25.5	2.0	0.00	-0.30	1.76	2.08	16.0	B
Gilead Sciences GILD	14895.5	34	18	NM	38.1	1068	29	12.2	26.8	1.7	0.00	-0.18	0.94	1.17	21.0	B-
(B) PHARMACEUTICALS																
INDUSTRY AVERAGE	46569.5	34	-18	13.3	16.8	393	33	3.2	27.6	4.0	1.59	1.26	1.77	2.03	12.6	
Abbott Laboratories ABT	65348.2	42	-10	2.6	24.3	504	21	3.3	14.6	1.5	2.48	1.75	2.27	2.51	12.0	A
Allergan AGN	9649.0	74	-4	NM	17.4	967	57	4.9	39.9	1.4	0.49	-0.40	2.74	3.23	18.5	B
Alpharma ALO	875.1	17	-17	NA	0.5	78	166	0.7	8.6	2.7	1.08	0.38	0.68	0.86	9.3	B-
Barr Pharmaceuticals BRL (6)	4035.1	39	-24	82.1c	13.0	382	31	3.2	23.5	2.1	0.00	1.62	1.15*	2.37	16.4	B
Bristol-Myers Squibb BMY	45721.8	24	-18	-3.6	25.8	429	17	2.1	12.5	NM	4.77	1.59	1.64	1.40	-1.0	A
Forest Laboratories FRX (3)	14355.2	39	-37	55.9	24.2	388	16	4.7	15.6	0.8	0.00	1.95	2.52	2.66	19.0	B+
IVAX IVX	3913.5	16	-18	9.9	14.0	334	24	2.3	15.7	0.9	0.00	0.40	0.72	0.84	23.0	B-
Johnson & Johnson JNJ	179055.1	60	17	14.1	29.0	568	20	3.9	16.0	1.6	1.89	2.40	3.07	3.34	12.0	A+
King Pharmaceuticals KG	3008.5	12	-18	-2.2	0.2	159	NM	2.3	18.7	2.3	0.00	0.44	0.59	0.99	9.0	NR
Lilly (Eli) LLY	60350.3	53	-24	0.4	22.6	534	23	4.4	19.3	1.6	2.66	2.37	2.81	3.11	12.3	B+
Merck MRK	62119.0	28	-39	4.5	35.3	359	10	2.7	NA	3.6	5.42	2.92	2.61	2.57	3.0	A+
Mylan Laboratories MYL (3)	4887.2	18	-28	23.7	16.3	274	17	3.7	14.6	1.5	0.66	1.21	0.83	1.10	14.3	A-
Pfizer PFE	209135.7	28	-21	-27.8	13.3	307	23	4.0	14.3	1.2	2.45	0.22	2.13	2.32	11.0	A
Schering-Plough SGP	26288.8	18	3	NM	-3.7	386	NM	3.3	174.1	36.1	1.23	-0.06	0.02	0.24	22.5	A
Watson Pharmaceuticals WPI	3180.5	29	-37	0.5	6.8	146	22	2.0	12.6	1.5	0.00	1.86	1.82	1.99	10.4	B+
Wyeth WYE	53188.8	40	-6	NM	30.0	478	16	3.1	13.6	1.6	2.31	1.54	2.68	2.89	9.5	B

INDUSTRIALS

SECTOR AVERAGE	10509.1	42	17	3.8	14.3	516	31	1.0	13.4	3.0	1.00	1.24	1.77	2.40	12.8	
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16 CAPITAL GOODS

INDUSTRY GROUP AVERAGE	13613.1	47	21	5.8	13.6	306	24	1.0	13.8	1.7	1.10	1.66	2.45	2.99	12.4	
(A) AEROSPACE & DEFENSE																
INDUSTRY AVERAGE	18297.8	60	24	19.1	20.3	382	22	1.2	14.8	1.8	1.24	2.43	3.08	3.47	11.4	
Alliant Techsystems ATK (3)	2481.5	66	14	21.8	24.4	402	17	1.0	11.5	1.7	0.00	4.14	3.99	4.49	10.0	B+
Boeing BA	42897.7	54	27	-22.7	28.8	450	16	0.8	NA	1.9	1.49	0.89	2.54	2.56	11.0	B
General Dynamics GD	21689.6	108	20	3.5	17.2	320	19	1.1	14.5	1.6	1.33	5.00	6.04	6.73	11.0	B+
Goodrich GR	3776.1	32	7	NA	10.9	291	27	0.8	10.4	1.6	2.52	0.33	1.50	1.78	13.0	B
Honeywell International HON	30389.7	35	6	-5.4	12.8	271	21	1.2	15.0	1.6	2.12	1.56	1.68	2.02	13.2	B
L-3 Communications Holdings LLL	7978.6	74	45	33.5	11.3	249	22	1.2	17.3	1.5	0.54	2.71	3.33	3.93	15.0	NR
Lockheed Martin LMT	26932.4	61	18	5.4	17.1	372	22	0.8	14.2	2.0	1.64	2.34	2.72	3.31	11.0	B-
Northrop Grumman NOC	20020.4	56	18	-10.6	6.2	125	20	0.7	NA	1.9	1.63	2.16	3.03	3.54	10.0	B+
Precision Castparts PCP (3)	4224.3	65	43	8.4	11.2	266	23	1.6	15.4	1.7	0.19	2.35	3.46	4.00	11.0	B+
Raytheon RTN	18237.7	40	34	-2.7a	4.1	181	42	0.9	21.6	2.8	1.98	1.29	1.45	1.86	10.0	B-
Rockwell Collins COL (9)	7047.2	40	33	NA	26.6	622	24	2.4	17.9	2.0	1.20	1.43	1.67*	1.93	12.0	NR
United Defense Industries UDI	2328.1	45	42	149.4	72.9	1037	15	1.0	11.1	1.3	0.00	2.66	3.13	2.89	11.0	NR
United Technologies UTX	49867.6	98	3	29.7	20.9	382	18	1.4	13.5	1.8	1.43	4.69	5.50	6.13	10.0	A+
(B) BUILDING PRODUCTS																
INDUSTRY AVERAGE	4724.4	33	18	1.3	14.2	345	18	0.6	11.5	1.1	1.09	1.41	2.10	2.39	14.3	
American Standard ASD	8345.5	39	16	10.6	50.6	871	13	0.9	12.7	1.2	0.00	1.83	2.23	2.56	14.5	B-
Griffon GFF (9)	736.6	25	24	24.6c	17.5	239	15	0.5	9.3	NA	0.00	1.28	1.71*	1.87	NA	B
Lennox International LII	1116.9	18	8	-5.9	-21.3	252	NM	0.4	NM	0.9	2.11	1.40	1.39	1.59	15.0	NR
Masco MAS	15844.0	35	29	5.6	17.5	302	18	1.3	13.6	1.1	2.04	1.51	2.31	2.56	14.5	A-
Universal Forest Products UFPI	772.8	43	33	10.4	13.3	222	17	0.3	10.2	NA	0.23	2.18	2.50	2.84	NA	A
York International YRK	1530.5	37	0	-37.7	7.4	183	25	0.3	11.4	1.2	2.17	0.28	2.43	2.90	13.0	B
(C) CONSTRUCTION & ENGINEERING																
INDUSTRY AVERAGE	1436.1	29	20	9.3	8.5	187	21	0.4	17.7	2.1	0.27	1.15	1.09	1.63	12.0	
Emcor Group EME	700.6	46	5	-16.7	4.6	128	28	0.1	14.1	3.7	0.00	1.33	1.19	2.58	10.6	B
Fluor FLR	4347.3	52	31	44.9	15.5	354	22	0.5	15.9	1.9	1.23	2.23	2.15	2.51	12.5	B
Granite Construction GVA	1104.5	27	13	2.8	9.6	208	21	0.5	9.8	1.9	1.51	1.48	1.18	1.44	12.0	A-

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AHEAD

EARNINGS PER SHARE

ESTIMATES FROM ANALYSTS

COMPANY	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Jacobs Engineering Group JEC	2,688.8	46	-4	24.1c	12.8	258	20	0.6	15.6	1.4	0.00	2.27	2.25*	2.54	15.0	B+
McDermott International MDR	1103.2	17	38	NM	NM	NM	NM	0.5	NM	NA	0.00	-1.59	0.31	0.90	NA	C
Perini P	366.6	15	63	4.9	31.5	226	7	0.2	6.5	1.0	0.00	2.10	1.03	1.15	15.0	B-
Quanta Services PWR	913.5	8	6	NM	-5.6	139	NM	0.6	40.5	NM	0.00	-0.30	-0.09	0.18	15.7	NR
Seaw Group SGP	939.3	15	8	NM	-3.0	106	NM	0.3	27.3	NM	0.00	0.53	-0.45*	0.78	8.5	B
URS WBE (10)	1305.0	30	20	-4.5	5.3	126	20	0.4	13.4	1.6	0.00	1.76	1.54	2.20	12.0	B+
Washington Group International WGI	992.1	39	15	NA	5.7	139	26	0.4	16.6	3.0	0.00	1.66	1.83	2.00	7.0	NR
(D) ELECTRICAL EQUIPMENT																
INDUSTRY AVERAGE	6557.5	40	14	-0.2	12.5	315	22	1.3	14.1	2.1	1.85	1.54	1.84	2.19	12.2	
Acuity Brands AY (8)	1253.6	29	14	17.4ac	14.1	262	19	0.6	11.4	NA	2.04	1.15	1.56*	1.70	NA	NR
American Power Conversion APCC	4043.3	21	-14	-4.2	12.9	278	23	2.5	17.2	-1.9	1.89	0.88	0.80	0.87	14.0	B+
Cooper Industries CBE	6063.7	66	14	-4.3	15.2	282	19	1.4	13.7	1.8	2.11	2.92	3.56	4.08	10.3	B+
Emerson Electric EMR (9)	28026.2	67	3	-2.4c	17.4	387	22	1.8	15.5	1.5	2.48	2.41	2.98*	3.44	15.0	A
General Cable GGC	533.7	14	67	NM	-1.8	365	NM	0.3	14.0	3.5	0.00	-0.16	0.43	0.78	9.0	C
Hubbell HUBB	2959.9	49	10	-3.7	15.8	330	21	1.5	15.4	1.8	2.72	1.91	2.50	2.84	11.0	B+
Rockwell Automation ROK (9)	8693.7	47	33	0.4c	19.0	467	26	2.0	16.6	1.7	1.40	1.48	1.85*	2.24	15.0	B+
Smith (A.O.) AOS	886.1	30	-14	-4.6	7.3	148	21	0.6	9.1	2.6	2.13	1.76	1.04	1.54	11.0	B
(E) INDUSTRIAL CONGLOMERATES																
INDUSTRY AVERAGE	7412.2	51	22	-1.4	13.5	344	52	1.5	13.5	1.9	1.44	1.83	2.48	3.03	11.0	
Carlisle CSL	1867.0	60	-2	-2.3	16.0	260	16	0.8	10.8	1.8	1.54	2.88	3.70	4.36	9.0	A+
General Electric GE	373830.6	35	14	9.4	15.5	367	23	2.6	15.7	2.2	2.26	1.55	1.58	1.79	10.0	A+
Teleflex TFX	2034.8	51	4	2.3	9.8	180	18	0.8	9.1	2.0	1.74	2.73	2.56	3.18	10.0	A+
Textron TXT	9982.9	73	27	-14.2	8.6	265	31	1.0	15.0	1.8	1.93	2.05	3.31	3.98	12.0	B+
3M MMM	61963.5	80	-6	8.8	33.2	713	22	3.2	16.0	1.8	1.81	3.02	3.75	4.16	12.0	A-
Tyco International TYC (9)	68216.8	34	28	-12.5c	9.9	225	24	1.7	NA	1.9	0.15	0.52	1.41*	1.96	13.0	B-
Walter Industries WLT	952.7	25	89	NM	1.4	394	229	0.7	14.2	NA	0.64	0.08	1.04	1.79	NA	NR
(F) MACHINERY																
INDUSTRY AVERAGE	6870.3	53	20	4.1	14.8	305	20	1.1	11.5	1.5	1.06	1.71	2.98	3.69	13.0	
AGCO AG	1967.4	22	8	NM	10.5	150	13	0.4	8.6	1.1	0.00	0.98	1.76	2.07	11.0	B-
Briggs & Stratton BGG (6)	2024.3	39	16	0.1c	15.8	245	15	1.0	10.1	0.9	1.73	1.75	2.77*	3.20	15.0	B+
Caterpillar CAT	31240.1	92	10	4.6	26.1	445	18	1.1	9.7	1.3	1.79	3.13	5.72	7.01	12.0	B+
Crane CR	1785.8	30	-2	3.9	-20.2	305	NM	1.0	NM	1.5	1.32	1.75	1.97	2.13	10.0	B+
Cummins CMI	3447.5	80	63	-20.4	21.7	269	13	0.4	6.4	1.7	1.51	1.36	6.32	8.19	7.5	B-
Danaher DHR	17554.1	57	24	17.4	16.7	419	26	2.7	NA	1.7	0.11	1.69	2.28	2.60	15.0	A
Deere DE (10)	17800.0	72	10	28.8c	22.0	278	13	0.9	NA	1.3	1.56	2.64	5.56*	6.03	10.0	B
Donaldson DCI (7)	2674.7	31	5	12.0c	21.4	530	26	1.8	17.9	2.0	0.77	1.06	1.18*	1.40	13.0	A+
Dover DOV	8226.0	40	2	-5.4	13.2	278	21	1.6	15.0	1.5	1.58	1.40	2.04	2.38	13.0	A-
Eaton ETN	10238.1	67	25	-11.0	17.2	304	18	1.1	10.5	1.6	1.60	2.57	4.18	5.19	10.0	B+
Flowserve FLS	1382.7	25	21	31.6	6.9	163	24	0.6	11.4	1.8	0.00	0.96	1.25	1.58	11.5	B
Harsco HSC	2193.2	53	21	0.4	12.4	262	21	0.9	7.8	1.3	2.26	2.12	2.63	3.09	16.0	B+
Illinois Tool Works ITW	27862.9	94	12	5.1	16.8	369	23	2.5	17.5	1.7	1.19	3.37	4.38	5.13	13.0	A+
Ingersoll-Rand IR	12816.2	74	10	5.6	16.3	261	16	1.3	NA	1.5	1.18	3.44	4.89	5.52	10.0	A
ITT Industries ITT	7854.7	85	15	12.9	20.6	386	19	1.2	12.8	1.6	0.80	4.15	4.50	5.13	12.0	B
Kennametal KMT (6)	1901.7	51	29	4.6c	9.5	206	22	0.9	12.4	2.3	1.33	0.51	2.02*	2.98	11.0	B
Manitowoc MTW	1003.0	37	20	-25.6	11.3	299	27	0.6	11.0	0.8	0.75	0.69	1.51	2.45	30.0	B
Navistar International NAV (10)	2872.3	41	-14	NM	42.2	742	19	0.3	NA	1.5	0.00	-0.21	2.97	4.44	9.0	C
Oshkosh Truck OSK (9)	2163.5	63	23	20.9c	17.7	340	20	1.0	15.4	1.3	0.56	2.16	3.13*	3.76	15.0	A-
Paccar PCAR	13566.0	78	38	-2.3	22.2	364	17	1.3	NA	1.2	1.02	2.99	5.25	6.45	12.5	B+
Pall PLL (7)	3359.7	27	1	0.6c	13.8	311	23	1.9	NA	2.1	1.33	0.83	1.20*	1.44	11.0	B
Parker Hannifin PH (6)	8936.7	75	26	-3.1c	13.5	287	21	1.2	13.2	2.2	1.02	1.68	2.91*	4.64	11.5	A-
Pentair PNR	4027.1	40	75	7.1	9.9	290	29	1.7	NA	2.3	1.10	1.45	1.35	2.05	13.0	A-
Reliance Steel & Aluminum RS	1300.1	40	20	-15.3	17.5	167	10	0.5	7.1	0.5	0.70	1.07	4.89	3.61	15.0	B+
SPX SPW	3088.8	41	-30	24.5	8.4	144	17	0.6	NA	1.3	2.43	3.41	2.14	3.08	15.0	B-
Terex TEX	2259.9	46	61	NM	11.5	242	22	0.5	NA	0.8	0.00	-0.53	2.47	3.50	22.5	C
Timken TKR	2347.1	26	30	-18.8	8.2	205	25	0.5	7.5	1.9	2.00	0.44	1.26	1.67	11.0	B-
Toro TTC (10)	1664.8	73	56	24.0c	26.0	421	18	1.0	12.0	1.4	0.33	3.12	4.04*	4.57	12.5	A-
Trinity Industries TRN	1679.2	35	15	NM	-1.0	167	NM	0.8	NA	NM	0.68	-0.25	-0.18	1.69	8.0	B-
(G) TRADING COMPANIES & DISTRIBUTORS																
INDUSTRY AVERAGE	2139.3	37	35	3.3	0.4	207	20	0.7	15.6	1.6	0.93	0.54	1.88	2.32	12.7	
Applied Industrial Technologies AIT (6)	820.0	42	75	1.9c	11.2	232	21	0.5	14.5	1.4	1.34	1.03	1.60*	2.48	19.0	B+
Grainger (W.W.) GWW	5572.5	62	31	6.4	13.2	285	22	1.1	16.3	1.7	1.29	2.46	2.88	3.33	12.5	A-
Hughes Supply HUG (1)	2026.7	33	33	-2.8	9.1	164	18	0.5	14.8	1.2	0.79	1.23	1.92	2.15	14.5	A-
United Rentals URI	1391.7	18	-7	NM	-43.0	136	NM	0.5	NM	2.0	0.00	-3.35	1.21	1.64	7.5	NR
Watsco WSO	885.4	33	45	7.8	11.5	220	19	0.7	16.8	1.9	1.21	1.34	1.77	2.03	10.0	A
17 COMMERCIAL SERVICES & SUPPLIES																
INDUSTRY GROUP AVERAGE	5386.4	34	6	0.4	16.2	1336	58	1.5	14.8	2.1	1.38	1.18	1.64	1.95	13.2	
ABM Industries ABM (10)	1064.0	22	26	-1.9	8.8	234	27	0.5	18.4	2.3	1.82	0.73	0.84	1.07	11.5	A
Allied Waste Industries A.W.	2886.1	9	-35	NM	0.7	129	NM	0.5	4.7	1.3	0.00	-2.36	0.43	0.55	16.0	C



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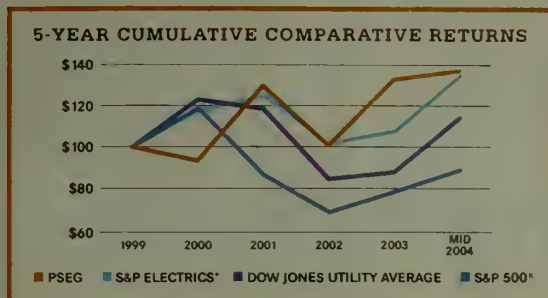
Source is Dealogic. *Relates to total \$ amount, w/over-allotment, of US IPOs priced between 1/1/03 and 12/31/03, with full credit to all bookrunners, excluding American Depositary Receipts and closed-end funds. 1 Relates to all public US equity transactions (IPOs and secondaries/follow-ons, excluding closed-end funds) and all industries. Transactions and performance priced thru 12/31/03. Non-weighted average aftermarket performance. Ranked among lead managing underwriters of more than 10 transactions for the 1 year period, and more than 30 transactions for the 3 and 5 year periods. Past results are no guarantee of future performance.

	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE- SALES RATIO	PRICE- CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
													2004 ANALYST EST.	2005 CON- SENSUS	LONG-TERM GROWTH RATE %		
Alcoa	14987.1	80	18	16.7c	29.0	1566	104	8.3	46.5	4.1	0.00	1.30	0.77*	2.40	25.0	B+	
Alcoa	4857.4	26	-5	13.8c	22.9	423	19	0.5	8.7	1.6	0.84	1.34	1.36*	1.53	12.0	NR	
Alcoa	5862.8	59	5	3.6	16.6	413	25	1.1	13.8	1.7	2.59	2.43	2.95	3.28	12.0	A	
Alcoa	1.09.3	45	10	32.7	11.9	219	19	0.7	NA	2.8	1.53	1.81	2.67	3.05	6.0	B	
Alcoa (H&L) (H)	7929.5	48	-14	32.8	44.6	603	15	1.9	9.5	1.2	1.84	3.90	3.51	4.04	11.5	A-	
Alcoa	2189.2	39	71	-39.6	12.0	366	29	0.5	9.0	1.8	0.26	0.34	1.82	2.13	11.5	B-	
Cendant CD	23867.9	23	2	NM	14.1	192	14	1.2	NA	0.9	1.59	1.41	1.72	1.83	14.0	B-	
Cintas C.TAS (5)	7670.2	45	-11	8.2	14.3	390	27	2.7	19.2	1.7	0.65	1.58	1.77	2.05	15.0	A+	
Deluxe DLX	1985.9	40	-4	7.3	NM	NM	11	1.4	7.8	NA	3.74	3.49	3.82	3.33	NA	B+	
Donnelley (R.R.) RRD	7665.2	35	15	-10.3	5.6	203	24	1.2	13.3	2.4	3.00	1.54	1.59	1.98	9.0	B	
Dun & Bradstreet DNB	4124.6	59	17	24.4	NM	24551	21	2.9	15.7	-1.4	0.00	2.30	2.97	3.44	14.5	NR	
Equifax EFX	3593.4	28	13	5.6	45.2	779	18	2.9	12.3	1.8	0.43	1.31	1.60	1.70	9.5	B+	
HNI HNI	2381.3	42	-2	4.1	16.4	347	22	1.2	13.3	1.4	1.32	1.68	2.07	2.37	15.0	A-	
IKON Office Solutions IKN (9)	1654.9	11	-5	36.2c	5.3	96	19	0.4	8.4	2.0	1.42	0.75	0.60*	0.65	9.5	B-	
Kelly Services KELYA	1070.5	30	7	-50.7	2.4	171	71	0.2	17.8	3.3	1.32	0.14	0.61	1.42	15.0	A-	
Manpower MAN	4361.2	48	3	-2.3	11.1	214	19	0.3	14.2	1.4	0.83	1.74	2.40	2.85	14.0	B+	
Miller (Herman) MLHR (5)	1744.0	25	1	-23.9	28.2	968	35	1.3	16.6	1.7	1.18	0.59	0.89	1.20	16.0	B+	
Pitney Bowes PBI	10094.2	44	8	0.1	44.4	830	19	2.1	12.0	2.2	2.79	2.10	2.50	2.62	8.0	A-	
Republic Services RSG	4745.2	31	23	4.1	12.8	258	21	1.8	9.7	1.6	1.52	1.33	1.55	1.76	12.5	NR	
Robert Half International RHI	4647.8	27	16	-52.4	11.2	544	49	1.9	31.2	2.0	0.89	0.04	0.77	1.00	18.0	B	
ServiceMaster SVM	3830.0	13	13	NM	20.8	459	22	1.0	NA	2.2	3.34	-0.75	0.59	0.66	10.0	A	
Spherion SFN	480.2	8	-20	NM	0.2	112	788	0.2	15.2	2.7	0.00	-0.18	0.20	0.41	15.0	C	
Steelcase SCS (2)	1972.5	13	-7	NM	-1.9	166	NM	0.8	17.8	7.3	1.80	-0.28	0.11	0.27	16.5	NR	
United Stationers USTR	1582.2	48	17	-0.1	13.0	223	18	0.4	13.2	1.2	0.00	2.37	2.86	3.32	14.0	B	
Waste Management WMI	17075.8	30	1	NM	15.2	292	19	1.4	7.7	1.7	2.52	1.21	1.39	1.67	13.0	B	

18 TRANSPORTATION

INDUSTRY GROUP AVERAGE	7265.4	35	18	1.6	14.6	331	26	0.8	11.4	7.8	0.45	0.28	0.22	1.33	13.5	
(A) AIR FREIGHT & LOGISTICS																
INDUSTRY AVERAGE	15741.6	54	47	8.8	15.6	439	28	1.0	18.0	1.7	0.57	1.54	2.27	2.64	16.0	
CNF CNF	2388.0	47	38	-17.9	18.4	378	20	0.6	9.7	1.4	0.86	1.57	2.55	3.23	13.5	B-
EGL EAGL	1527.5	34	92	-18.2	10.9	367	36	0.6	19.2	1.6	0.00	0.50	1.04	1.33	20.0	NR
Expeditors Intl. of Washington EXPD	5664.7	53	41	18.4	19.6	744	39	1.8	32.4	2.5	0.41	1.12	1.42	1.70	15.0	A+
FedEx FDX (5)	28563.2	95	41	4.4	12.4	340	28	1.1	11.7	1.4	0.29	2.76	4.69	5.18	15.0	B+
Hub Group HUBG	435.0	44	102	-2.8	6.1	204	30	0.3	17.7	0.9	0.00	1.07	2.15	2.46	22.5	B-
Pacer International PACR	729.1	20	-3	21.5	16.8	295	18	0.4	14.9	1.2	0.00	0.82	1.18	1.36	13.5	NR
Robinson (C.H.) Worldwide CHRW	4584.2	54	42	20.0	21.7	776	36	1.1	32.9	2.3	1.12	1.33	1.56	1.80	15.0	B+
Ryder System R	3450.8	54	57	19.3	13.4	239	18	0.7	3.9	NA	1.12	2.12	2.90	3.30	NA	B
United Parcel Service UPS	94332.2	84	13	34.3	21.5	609	29	2.6	19.4	2.1	1.33	2.55	2.95	3.41	13.5	NR
(B) AIRLINES																
INDUSTRY AVERAGE	1997.4	11	-30	-22.9	21.8	285	30	0.3	5.6	52.0	0.01	-3.78	-4.70	-1.85	8.9	
Alaska Air Group ALK	839.6	31	14	-43.2	2.6	118	45	0.3	3.7	153.1	0.00	0.51	0.03	2.02	6.0	C
America West Holdings AWA	209.0	6	-53	-14.9	-29.6	185	NM	0.1	9.5	NM	0.00	1.29	-2.73	-1.86	10.5	C
AMR AMR	1452.3	9	-30	NM	NM	NM	NM	0.1	1.8	NM	0.00	-7.76	-5.69	-3.04	7.0	C
Continental Airlines CAL	740.4	11	-32	-46.4	-16.1	108	NM	0.1	2.4	NM	0.00	0.58	-4.07	-2.36	6.5	C
Delta Air Lines DAL	888.7	7	-41	NM	NM	NM	NM	0.1	NM	NM	0.00	-6.40	-14.91	-6.10	6.0	C
ExpressJet Holdings XJT	634.0	12	-22	NM	146.3	792	5	0.4	4.5	0.4	0.00	1.80	2.15	1.69	15.0	NR
Northwest Airlines NWAC	886.1	10	-19	-7.1	NM	NM	NM	0.1	1.9	NM	0.00	2.74	-7.46	-2.60	6.0	C
Southwest Airlines LUV	12262.8	16	-3	-2.9	5.9	223	39	1.9	15.5	2.5	0.11	0.54	0.43	0.55	14.5	A
US Airways Group UAIRQ	63.4	1	-82	NA	NM	NM	NM	0.0	NM	NM	0.00	-27.31	-10.04	-5.00	NA	D
(C) ROAD & RAIL																
INDUSTRY AVERAGE	5202.9	39	29	6.3	11.3	277	24	0.9	10.0	1.3	0.65	2.09	2.05	2.54	14.7	
Arkansas Best ABFS	1084.2	43	37	-6.1	14.8	244	17	0.7	9.0	0.8	1.11	1.81	2.99	3.53	18.8	B-
Burlington Northern Santa Fe BNI	16866.3	45	39	-3.9	7.4	186	25	1.6	10.2	1.2	1.51	2.09	2.72	3.19	14.0	A-
CSX CSX	8191.4	38	6	55.6	5.8	120	21	1.0	7.8	1.7	1.05	0.88	2.03	2.56	11.0	B-
Hunt (J.B.) Transport Services JBHT	3265.5	40	49	27.8	18.3	390	22	1.2	10.8	1.1	0.30	1.17	2.07	2.39	18.0	B
Laidlaw International LI (8)	1890.5	19	37	NA	4.5	137	32	0.4	5.8	NA	0.00	9.83	0.59*	0.82	NA	B-
Landstar System LSTR	2131.7	71	85	9.4	33.8	1155	35	1.1	28.1	2.3	0.00	1.59	2.22	2.66	14.0	B
Norfolk Southern NSC	13594.9	34	45	13.6	9.2	177	19	1.9	10.9	1.1	1.17	1.05	2.12	2.41	15.0	B
Overnite OVNT	989.8	35	55	9.3	11.7	231	20	0.6	9.1	1.0	0.45	1.70	2.25	2.75	16.0	NR
SIRVA SIR	1463.6	20	2	NM	7.1	312	40	0.6	NA	1.2	0.00	0.27	0.85	1.27	20.0	NR
Swift Transportation SWFT	1524.4	19	-7	-4.7	11.4	187	17	0.6	5.7	1.2	0.00	0.94	1.14	1.32	14.5	B+
Union Pacific UNP	16450.1	63	-9	7.6	6.8	130	19	1.4	8.4	2.1	1.89	4.07	2.69	3.87	11.5	B
USF USFC	1034.1	37	8	-19.1	5.2	150	28	0.4	7.5	1.3	1.01	1.61	2.05	2.65	13.5	B+
Werner Enterprises WERN	1774.2	23	15	4.9	11.1	238	22	1.1	7.9	1.5	0.62	0.90	1.08	1.31	14.0	A
Yellow Roadway YELL	2579.2	53	46	-18.8a	10.5	225	21	0.4	9.5	1.2	0.00	1.33	3.95	4.90	11.0	B-

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EARNINGS PER SHARE

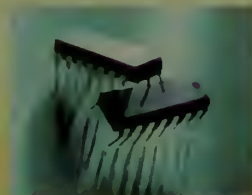
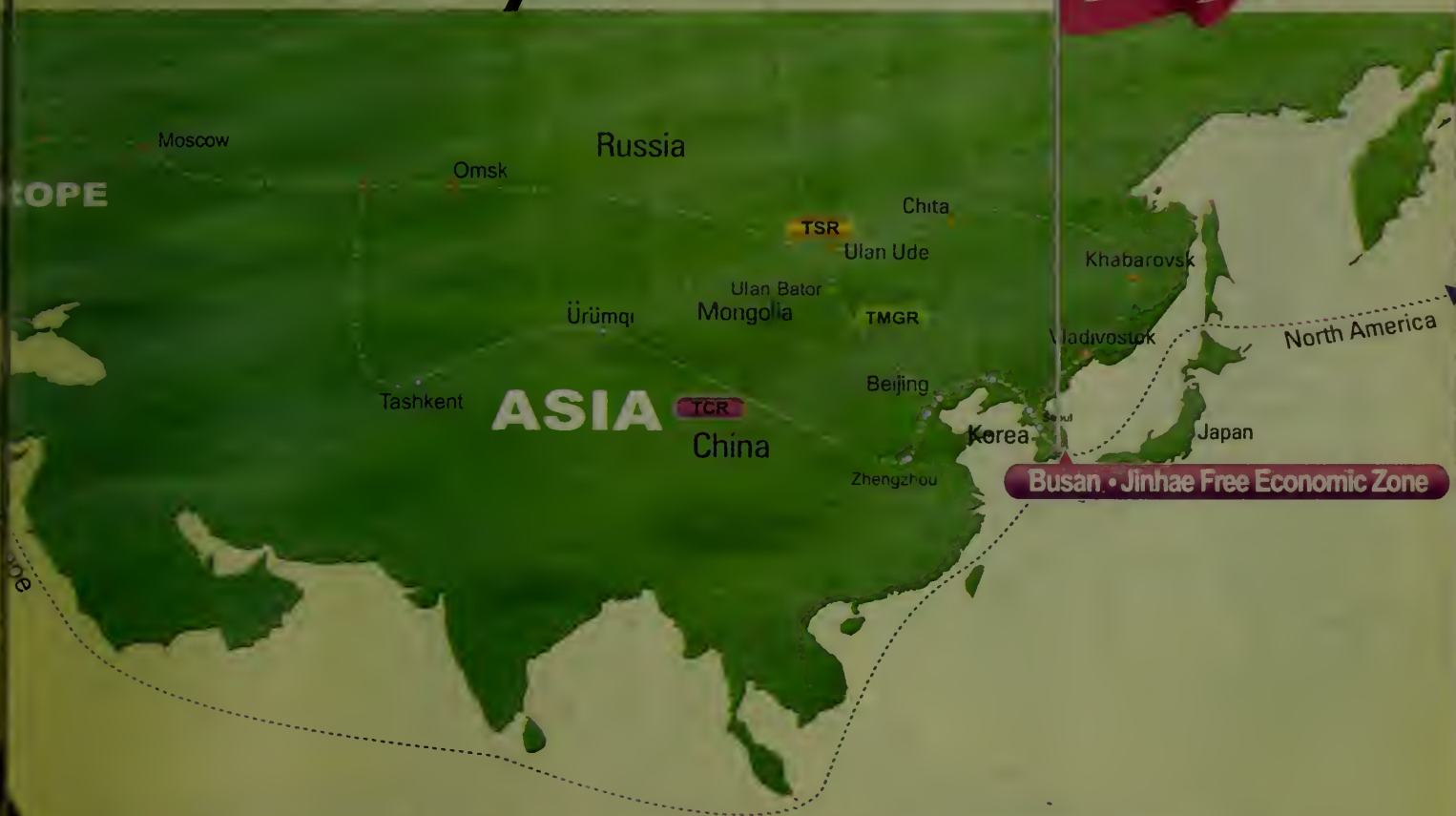
ESTIMATES FROM ANALYSTS

COMPANY	MARKET CAP	RECEIVED SHARES	PRICE PER SHARE	EARNINGS GROWTH 2003-2004 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE- SALES RATIO	PRICE- CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST	2005 CON- SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
INFORMATION TECHNOLOGY																
INDUSTRY GROUP AVERAGE	28474.2	28	3	-2.7	11.1	387	40	2.8	22.2	2.1	0.20	0.48	1.06	1.27	15.0	
INTERNET SOFTWARE & SERVICES																
INDUSTRY AVERAGE	32583.2	77	38	44.3	11.3	996	113	11.5	73.0	2.3	0.00	0.06	1.25	1.62	25.2	
EarthLink ELNK	1621.9	11	8	NM	16.5	310	20	1.2	9.3	1.1	0.00	-0.42	0.88	0.96	11.5	NR
Google GOOG	49722.0	182	NA	NM	8.6	1920	219	18.6	153.7	2.1	0.00	0.41	2.54	3.39	34.0	NR
Yahoo! YHOO	46405.8	38	67	44.3	8.9	759	100	14.7	55.9	3.6	0.00	0.19	0.35	0.50	30.0	NR
(B) IT SERVICES																
INDUSTRY AVERAGE	8439.5	30	-1	6.0	14.5	361	23	2.0	21.2	2.1	0.28	1.13	1.37	1.52	14.4	
Accenture ACN (8)	14844.9	26	-1	NA	46.9	1009	21	1.0	15.7	1.4	0.00	1.05	1.22*	1.38	15.0	NR
Affiliated Computer Services ACS (6)	7630.8	59	e	38.0c	19.8	281	15	1.9	10.4	0.8	0.00	2.20	3.83*	3.12	19.0	B+
Automatic Data Processing ADP (6)	26522.9	46	15	4.2c	17.5	490	29	3.4	21.1	2.8	1.36	1.68	1.56*	1.77	10.5	A+
BearingPoint BE	1732.8	9	-14	NA	3.4	147	NM	0.5	13.1	2.4	0.00	0.22	0.25	0.49	14.5	NR
Ceridian CEN	2796.5	19	-10	3.9	9.2	223	25	2.2	NA	2.0	0.00	0.83	0.68	0.87	14.0	B-
Computer Sciences CSC (3)	10235.1	54	22	3.4	9.7	177	18	0.7	6.4	1.5	0.00	2.75	3.18	3.53	11.0	B+
Convergys CVG	2105.6	15	-15	8.9	11.4	172	15	0.9	8.3	1.8	0.00	1.15	0.88	1.00	9.2	NR
DST Systems DST	4080.4	49	17	26.6	42.5	542	15	1.7	8.5	1.3	0.00	2.77	2.42	2.64	15.0	NR
Electronic Data Systems EDS	11520.4	22	-9	NM	-9.4	158	NM	0.5	NA	9.1	0.89	-0.53	0.25	0.74	10.0	B+
First Data FDC	34096.5	41	0	7.8	18.9	357	19	3.6	13.7	1.3	0.19	1.86	2.16	2.44	15.0	A-
Fiserv FISV	7531.4	39	-3	21.4	14.4	299	21	2.0	13.6	1.3	0.00	1.61	1.91	2.20	16.1	B+
Hewlett Associates HEW (9)	2956.3	30	1	NA	14.3	344	24	1.3	14.4	1.6	0.00	0.97	1.25*	1.34	15.0	NR
Iron Mountain IRM	3897.6	30	14	NM	8.0	335	43	2.2	15.6	2.0	0.00	0.65	0.67	0.70	23.0	B-
Paychex PAYX (5)	12541.0	33	-11	11.9	24.7	999	41	9.4	34.2	2.1	1.57	0.80	0.94	1.09	17.0	A+
Perot Systems PER	1854.3	16	19	-13.8	10.2	225	23	1.1	13.8	1.4	0.00	0.45	0.75	0.86	15.0	NR
Sabre Holdings TSG	3126.8	23	7	-28.4	9.3	188	21	1.5	11.3	1.3	1.30	0.58	1.44	1.58	12.0	NR
SunGard Data Systems SDS	7658.0	27	-4	34.3	14.6	247	17	2.2	11.4	1.4	0.00	1.27	1.41	1.59	13.9	B+
Titan TTN	1359.8	16	-26	-17.0	-2.3	413	NM	0.7	140.6	1.1	0.00	0.35	0.77	0.97	19.0	C
Unisys UIS	3859.8	11	-23	-16.8	12.0	251	21	0.7	9.0	2.5	0.00	0.78	0.50	0.58	9.0	B-
(C) SOFTWARE																
INDUSTRY AVERAGE	38503.7	28	5	-7.5	13.6	479	66	5.2	36.6	2.5	0.13	0.58	0.91	1.09	13.3	
Adobe Systems ADBE (11)	14346.7	61	55	3.9	34.3	1170	36	9.0	30.1	2.3	0.08	1.10	1.79	1.96	15.0	B+
BMC Software BMC (3)	4123.9	19	0	NM	1.3	338	310	2.8	26.8	2.5	0.00	-0.12	0.73	0.87	10.0	C
Computer Associates International CA (3)	17879.7	31	12	NM	0.1	378	NM	5.3	131.5	2.7	0.26	-0.06	0.81	0.99	14.0	B-
Compuware CPWR (3)	2233.9	6	-4	-39.7	4.4	156	34	1.8	18.0	3.0	0.00	0.13	0.16	0.22	12.0	NR
Electronic Arts ERTS (3)	14919.3	49	3	NM	20.8	513	25	4.6	21.8	1.4	0.00	1.87	1.95	2.07	17.5	B+
Intuit INTU (7)	7953.4	42	-21	0.0c	20.0	483	26	4.2	NA	1.8	0.00	1.25	1.58*	1.95	15.0	B-
Microsoft MSFT (6)	291290.6	27	-2	-4.4c	10.6	384	36	7.7	31.1	3.3	1.19	0.69	0.75*	1.25	11.0	B+
Oracle ORCL (5)	65878.5	13	-4	-17.7	34.3	822	24	6.4	22.1	2.2	0.00	0.50	0.58	0.65	10.0	B
PeopleSoft PSFT	8871.4	24	4	NM	2.6	292	112	3.3	28.8	3.5	0.00	0.25	0.68	0.83	10.0	B
Siebel Systems SEBL	5116.6	10	-28	NM	4.6	236	53	3.9	21.9	3.4	0.00	-0.01	0.20	0.27	15.0	NR
Symantec SYMC (3)	20185.7	32	85	13.1	17.5	734	47	9.1	34.2	2.2	0.00	0.54	0.83	0.98	17.5	B
Veritas Software VRTS	9244.6	22	-41	NM	12.3	241	20	4.7	NA	1.9	0.00	0.81	0.91	1.02	13.0	B-
20 SEMICONDUCTORS & SEMICONDUCTOR EQUIPMENT																
INDUSTRY GROUP AVERAGE	16394.5	20	-25	-10.2	8.0	311	54	3.0	13.8	2.4	0.24	-0.26	0.68	0.76	17.1	
Advanced Micro Devices AMD	7572.2	21	43	NM	6.4	294	47	1.5	5.6	2.8	0.00	-0.79	0.52	0.72	15.0	C
Agere Systems AGA (9)	2357.4	1	-55	NM	-21.4	560	NM	1.2	NA	NM	0.00	-0.22	-0.05*	-0.03	10.0	NR
Amkor Technology AMKR	966.4	6	-70	NM	5.4	245	46	0.5	3.9	NM	0.00	-0.31	-0.27	-0.48	17.5	C
Analog Devices ADI (10)	13887.3	37	-19	-2.9c	15.0	365	25	5.3	19.2	1.3	0.65	0.78	1.45*	1.37	20.0	B
Applied Materials AMAT (10)	28258.6	17	-26	-11.1c	14.6	305	21	3.5	NA	1.4	0.00	-0.09	0.78*	0.67	15.0	B-
Atmel ATML	1694.6	4	-41	NM	1.5	166	355	1.0	5.5	NM	0.00	-0.25	-0.01	0.02	20.0	C
Broadcom BRCM	10731.6	33	-4	NM	6.9	483	72	4.6	43.5	1.3	0.00	-3.29	1.22	1.09	20.0	C
Fairchild Semiconductor Intl. FCS	1828.6	15	-39	NM	4.0	151	39	1.1	8.2	1.2	0.00	-0.69	0.83	0.75	15.0	NR
Freescale Semiconductor FSL	7064.0	18	NA	NA	7.9	183	NA	1.2	6.7	3.2	0.00	-1.32	0.55	0.78	10.0	NR
Intel INTC	141508.7	22	-30	-6.2	19.8	370	13	4.2	11.3	1.3	1.43	0.85	1.11	1.10	15.0	A
KLA-Tencor KLAC (6)	8807.1	45	-23	-2.6c	12.0	328	28	5.2	21.8	1.9	0.00	0.70	1.21*	2.21	20.0	B
LSI Logic LSI	2036.3	5	-40	NM	-14.5	114	NM	1.2	NM	13.1	0.00	-0.82	0.03	0.02	15.0	C
Maxim Integrated Products MXIM (6)	13322.2	41	-17	2.1c	21.4	598	30	8.5	NA	1.4	0.98	0.91	1.20*	1.63	25.0	B+
Micron Technology MU (8)	6775.4	11	-18	-45.9c	2.8	121	46	1.5	4.9	2.6	0.00	-2.11	0.24*	0.66	18.0	C
National Semiconductor NSM (5)	5536.8	15	-22	-18.5	20.3	303	16	2.6	9.6	1.3	0.52	0.73	0.78	0.83	15.0	B-
NVIDIA NVDA (1)	3179.7	19	-18	7.9	6.9	287	43	1.7	18.5	2.1	0.00	0.43	0.45	0.71	20.0	B-
Teradyne TER	3312.4	17	-33	NM	13.3	292	23	1.9	11.9	1.4	0.00	-1.03	0.82	0.23	15.0	C
Texas Instruments TXN	41781.2	24	-18	-5.4	14.6	324	23	3.4	12.2	1.2	0.41	0.68	1.03	1.12	20.0	B
Xilinx XLNX (5)	10874.3	31	-19	-18.9	14.9	424	29	6.8	24.5	1.6	0.64	0.85	0.97	1.08	20.0	B

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COMPANY	MARKET SHARE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 12/9-2003 %	RETURN ON EQUITY	PERCENTAGE OF BOOK VALUE	P/E RATIO	PRICE/SALES RATIO	PRICE/CASH FLOW RATIO	P/E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
21 SOFTWARE & EQUIPMENT																
INDUSTRY GROUP AVERAGE	17361.3	28	13	-4.9	10.4	365	30	1.9	18.2	1.9	0.17	0.53	1.11	1.39	14.1	
(A) TELECOMMUNICATIONS EQUIPMENT																
INDUSTRY AVERAGE	27986.6	25	24	2.8	5.8	413	43	4.4	27.6	2.6	0.21	0.39	0.80	1.06	13.5	
Avaya (9)	2281.3	14	23	-34.4c	2.1	150	71	1.2	16.7	7.1	0.00	0.11	0.20*	0.55	10.0	B
Avaya (9)	7484.7	16	27	NM	36.7	943	26	1.8	NA	2.6	0.00	-0.34	0.63*	0.82	10.0	NR
Cisco Systems CSCO (7)	123581.3	19	-23	17.0c	21.5	503	25	5.4	18.7	1.8	0.00	0.50	0.70*	0.89	15.0	B+
Corning GLW	17624.6	13	21	NM	-66.6	503	NM	4.8	NM	1.9	0.00	-0.18	0.45	0.59	15.0	C
Harris HRS (6)	4416.5	66	74	NA	10.6	333	32	1.7	NA	2.3	0.73	1.06	1.88*	2.66	15.0	B-
Juniper Networks JNPR	14816.6	28	48	NM	1.5	255	153	13.3	89.7	3.1	0.00	0.10	0.44	0.65	20.0	NR
Lucent Technologies LU (9)	17272.4	4	38	1.7c	NM	NM	9	1.9	6.4	1.6	0.00	-0.29	0.42*	0.17	6.0	C
Motorola MOT	45551.4	19	38	-2.5	9.9	329	34	1.3	16.0	2.3	0.83	0.38	0.83	0.97	10.0	B+
Qualcomm QCOM (9)	68048.7	42	54	25.6c	17.9	704	40	13.9	36.5	2.0	0.67	0.63	1.03*	1.18	20.0	B
Scientific-Atlanta SFA (6)	4548.0	30	8	9.6c	12.4	244	20	2.6	NA	1.7	0.14	0.65	1.41*	1.52	12.5	A-
UTStarcom UTSI	2226.9	20	-47	NM	12.4	162	15	0.9	9.4	1.7	0.00	1.64	0.78	1.66	15.0	NR
(B) COMPUTERS & PERIPHERALS																
INDUSTRY AVERAGE	30786.0	36	19	-7.5	16.1	531	29	1.6	16.2	2.0	0.27	1.02	1.36	1.62	12.8	
Apple Computer AAPL (9)	26246.3	67	214	-25.6c	5.4	517	94	3.2	NA	4.7	0.00	0.19	0.71*	1.36	20.0	B-
Dell DELL (1)	100570.6	41	19	11.8	53.1	1710	33	2.1	29.2	1.6	0.00	1.01	1.28	1.56	19.5	B+
Diebold DBD	3800.0	53	-1	6.7	15.5	327	21	1.6	15.2	1.7	1.39*	2.40	2.56	3.08	12.0	A
EMC EMC	32158.1	13	4	-18.1	6.9	287	42	4.2	23.8	1.9	0.00	0.22	0.35	0.49	20.0	B
Gateway GTW	2543.2	7	48	NM	NM	1639	NM	0.7	NM	NM	0.00	-1.62	-0.32	0.17	12.0	C
Hewlett-Packard HPQ (10)	60600.0	20	-13	-10.4c	9.3	161	17	0.8	10.3	1.7	1.60	0.83	1.15*	1.53	10.0	A-
International Business Machines IBM	156881.0	94	2	2.1	27.3	528	20	1.7	13.0	1.9	0.76	4.34	5.01	5.53	10.0	B+
Lexmark International LXX	10952.1	85	8	8.7	27.1	536	20	2.1	15.8	1.8	0.00	3.34	4.08	4.42	11.5	B
Maxtor MXO	954.8	4	-66	NM	-12.0	153	NM	0.2	7.3	NM	0.00	0.40	-0.50	-0.33	10.0	NR
NCR NCR	5531.0	60	54	-35.2	12.6	289	24	0.9	10.6	2.6	0.00	0.61	1.52	2.28	15.0	NR
Seagate Technology STX (6)	6950.7	15	-21	NA	20.1	364	19	1.2	8.6	1.6	0.00	1.36	1.06*	0.38	9.0	NR
Storage Technology STK	3137.2	29	13	NM	12.6	228	19	1.4	12.3	1.5	0.00	1.35	1.58	1.72	12.0	B
Sun Microsystems SUNW (6)	18665.1	6	24	NM	-4.0	296	NM	1.7	41.1	NM	0.00	-1.07	-0.12*	0.06	8.0	C
Western Digital WDC (6)	2013.6	10	-17	NM	34.8	397	12	0.6	7.0	1.4	0.00	0.89	0.70*	0.52	10.0	B-
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS																
INDUSTRY AVERAGE	3059.6	25	4	-5.2	9.0	235	24	0.8	16.7	1.5	0.09	0.28	1.13	1.43	15.5	
Agilent Technologies A (10)	11147.4	23	-22	-16.6c	9.8	313	32	1.6	17.4	2.7	0.00	-3.78	0.71*	1.20	12.0	NR
Agilysys AGYS (3)	473.7	17	48	NM	7.2	148	21	0.3	17.2	1.3	0.73	0.41	0.88	1.01	15.0	B+
Amphenol APH	3106.7	35	10	18.4	34.9	720	21	2.1	16.4	1.1	0.00	1.18	1.80	2.11	17.5	B+
Anixter International AXE	1402.2	38	46	-11.3	8.6	197	24	0.5	17.2	1.4	0.00	1.13	1.64	1.94	16.0	B
Arrow Electronics ARW	2836.1	25	6	-31.9	9.2	141	15	0.3	11.3	1.0	0.00	0.25	1.97	2.10	12.5	B-
Avnet AVT (6)	2217.0	18	-15	-20.4c	6.0	110	19	0.2	12.2	2.0	0.00	-0.39	0.60*	1.37	15.0	C
Bell Microproducts BELM	241.2	9	-6	NM	3.9	118	29	0.1	11.2	NA	0.00	-0.20	0.38	0.64	NA	C
Benchmark Electronics BHE	1444.1	35	1	23.2	8.9	200	23	0.7	15.7	1.4	0.00	1.39	1.64	1.91	15.0	B-
Brightpoint CELL	343.9	19	11	NM	14.4	247	18	0.2	11.0	1.5	0.00	0.68	1.07	1.26	12.2	C
CDW CDWC	5452.7	66	14	16.5	19.1	467	26	1.0	22.8	1.3	0.55	2.03	2.78	3.15	18.5	B+
Ingram Micro IM	2998.6	19	21	-5.7	9.1	145	16	0.1	12.1	1.2	0.00	0.98	0.95	1.22	17.5	B-
Jabil Circuit JBL (8)	5044.6	25	-11	0.6c	9.2	277	31	0.8	13.0	1.2	0.00	0.21	0.81*	1.23	25.0	B
Mettler-Toledo International MTD	2255.2	52	22	14.5	15.5	335	23	1.6	17.3	1.8	0.00	2.11	2.34	2.70	12.0	NR
Molex MOLXE (6)	5194.6	28	-21	-4.8c	9.6	249	27	2.2	12.1	2.0	0.54	0.44	0.92*	1.26	15.0	A-
PC Connection PCCC	176.1	7	-15	-29.5	4.3	108	25	0.1	12.4	1.1	0.00	0.23	0.46	0.58	13.5	NR
Sanmina-SCI SANM (9)	4601.7	9	-30	NM	-0.3	137	NM	0.4	52.4	NM	0.00	-0.27	-0.02*	0.44	17.5	C
Soletron SLR (8)	6022.5	6	6	NM	-10.6	253	NM	0.5	NM	NM	0.00	-3.65	-0.29*	0.25	15.0	C
Symbol Technologies SBL	3651.1	15	-10	NM	6.9	360	52	2.2	27.1	1.9	0.13	0.01	0.40	0.63	20.0	B-
SYNNEX SNX (11)	578.5	21	56	4.3	11.7	169	15	0.1	12.3	1.2	0.00	1.22	1.44	1.61	12.5	NR
Tech Data TECD (1)	2637.5	45	14	-7.2	7.8	145	19	0.1	14.0	1.4	0.00	1.81	2.47	2.79	13.5	B-
Vishay Intertechnology VSH	2426.6	15	-36	-28.8	4.0	89	24	1.0	8.0	1.4	0.00	0.17	0.70	0.68	15.0	B-
(D) OFFICE ELECTRONICS																
INDUSTRY AVERAGE	12871.5	15	11	-25.0	12.5	286	20	0.8	8.9	1.8	0.00	0.36	0.85	0.94	10.0	
Xerox XRX	12871.5	15	11	-25.0	12.5	286	20	0.8	8.9	1.8	0.00	0.36	0.85	0.94	10.0	B
MATERIALS																
SECTOR AVERAGE	6239.1	40	26	1.0	9.1	320	28	1.1	11.6	5.1	1.47	0.52	2.26	2.78	8.6	

22 MATERIALS

INDUSTRY GROUP AVERAGE	6239.1	40	26	1.0	9.1	320	28	1.1	11.6	5.1	1.47	0.52	2.26	2.78	8.6	
(A) CHEMICALS																
INDUSTRY AVERAGE	7215.1	39	23	2.4	11.9	326	24	1.2	12.9	3.4	1.65	0.90	1.91	2.48	8.6	
Air Products & Chemicals APD (9)	12872.4	57	8	46.9c	13.6	290	22	1.7	9.9	2.2	2.03	1.79	2.64*	3.06	10.0	B+
Airgas ARG (3)	1987.3	27	24	18.4	11.6	264	23	0.9	10.7	2.0	0.68	1.07	1.25	1.51	10.5	B
Cabot CBT (9)	2321.3	38	18	0.0b	10.0	206	21	1.2	8.8	1.9	1.70	1.08	1.79*	2.36	11.0	B-
Crompton CK	1286.5	11	56	NM	-12.5	413	NM	0.5	15.2	11.0	1.78	-1.05	0.15	0.47	7.0	B-
Cytec Industries CYT	1925.2	49	27	-4.6	11.6	233	23	1.2	10.0	1.8	0.82	2.27	2.87	3.47	9.5	B



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EARNINGS PER SHARE

	MARKET VALUE	RECENT SHARE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1979-2003	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE SALES RATIO	PRICE- CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				S&P EQUITY RANKING
												2003 ACTUAL	2004 ANALYST EST	2005 CON- SENSUS	LONG-TERM GROWTH RATE %	
Dow Chemical	47591.7	50	21	0.3	25.7	453	18	1.3	10.2	2.9	2.66	1.88	2.49	3.74	7.0	B
DuPont	5033.5	45	-1	51.5	20.8	449	21	1.6	12.8	1.9	3.09	0.99	2.33	2.72	10.0	B
Dynalene Chemical	4229.9	54	38	NM	12.1	407	34	0.7	9.3	2.5	3.24	-3.54	2.67	3.52	8.0	B-
Dynalene	9007.8	35	28	12.0	20.9	613	30	2.2	17.5	2.3	0.91	1.06	1.20	1.33	13.0	A
Dynalene	3655.6	30	0	6.1	17.8	270	16	0.9	9.9	1.6	1.47	1.86	1.82	2.02	10.0	B+
Dynalene	1815.0	50	45	-31.2	14.0	260	18	0.9	7.9	2.7	0.00	1.12	3.24	3.73	5.6	B-
Dynalene (H.B.) - JUL 11	819.2	29	-4	-3.8	7.4	155	21	0.6	8.7	2.5	1.61	1.35	1.37	1.66	8.5	B+
Georgian Gulf GCO	1925.6	58	99	-27.2	34.6	833	24	1.0	13.4	5.4	0.56	0.38	3.22	5.13	3.3	B-
Great Lakes Chemical GLK	1497.2	29	8	NM	-2.0	186	NM	1.0	NA	4.4	1.30	-0.67	0.84	1.28	8.0	B
Hercules HPC	1667.8	15	22	-12.7	NM	NM	NM	0.9	22.5	2.2	0.00	0.69	0.89	1.14	7.5	B-
Lubrizol LZ	2258.6	35	6	-6.0	6.1	164	21	0.8	10.3	2.0	3.01	1.75	2.35	2.56	7.5	B
Lyondell Chemical LYO	5028.5	28	66	NM	-3.6	461	NM	1.1	23.6	15.3	3.21	-1.84	0.37	1.70	5.0	B-
Monsanto MON (8)	12168.3	46	60	8.3c	5.2	231	46	2.2	16.8	4.1	1.26	0.36	1.01*	1.96	11.0	NR
Olin OLN	1590.6	23	13	-51.5	8.9	440	48	0.8	14.9	4.6	3.53	0.02	0.70	1.69	7.0	B-
PolyOne POL	846.0	9	44	NM	-0.1	213	NM	0.4	19.2	NA	0.00	-1.05	0.65	0.75	NA	C
PPG Industries PPG	11597.6	67	5	-2.6	19.1	356	19	1.3	11.5	2.0	2.67	2.92	3.92	4.56	8.5	B
Praxair PX	14580.1	45	18	6.5	19.9	433	22	2.3	11.9	2.1	1.34	1.77	2.08	2.39	10.5	A
Rohm & Haas ROH	9860.4	44	3	7.0	13.4	276	21	1.4	10.3	2.1	2.27	1.30	2.09	2.48	10.0	A
RPM International RPM (5)	2149.9	18	12	34.1	14.6	211	15	0.9	10.1	1.4	3.24	1.22	1.35	1.51	10.0	A-
Schulman (A.) SHLM (8)	652.6	21	1	-22.7b	6.4	150	24	0.5	12.1	4.7	2.52	0.53	0.91*	1.23	5.0	B
Scotts SMG (9)	2234.7	69	16	NA	11.5	256	23	1.1	14.4	1.8	0.00	3.21	3.02*	4.45	12.5	B
Sigma-Aldrich SIAL	4121.4	60	4	16.2	19.9	365	19	3.0	13.9	1.8	1.14	2.68	3.35	3.38	10.0	A+
Valspar VAL (10)	2477.1	48	-2	8.4c	14.3	248	18	1.0	NA	1.5	1.49	2.17	2.71*	3.02	11.5	A-
Westlake Chemical WLK	2037.1	31	NA	NA	11.5	282	NA	1.1	NA	3.1	0.27	NA	2.15	3.19	4.7	NR

(B) CONSTRUCTION MATERIALS

INDUSTRY AVERAGE	3824.4	51	13	-4.3	11.0	203	18	1.4	9.2	1.5	1.78	2.39	2.98	3.31	11.5	
Lafarge North America LAF	3746.2	50	24	-5.9	9.2	131	14	1.0	8.0	1.4	1.75	2.93	3.67	4.01	10.0	A
Martin Marietta Materials MLM	2417.0	50	7	-5.2	10.2	207	21	1.4	9.5	1.6	1.59	2.06	2.53	2.86	12.5	B+
Vulcan Materials VMC	5309.9	52	9	-1.9	13.5	273	20	1.7	10.1	1.6	2.01	2.18	2.73	3.05	12.0	A-

(C) CONTAINERS & PACKAGING

INDUSTRY AVERAGE	2847.9	33	19	3.4	5.4	350	38	0.8	9.8	10.2	1.23	0.34	1.72	2.27	7.7	
Ball BLL	5032.8	45	50	25.1	29.6	506	17	0.9	9.8	1.6	0.89	2.01	2.56	2.78	11.0	B+
Bemis BMS	2977.1	28	11	6.1	13.8	240	18	1.1	9.9	1.7	2.30	1.37	1.65	1.79	10.0	A
Crown Holdings CCK	2116.6	13	41	NM	10.3	908	91	0.3	6.4	4.5	0.00	-0.19	0.52	0.71	5.5	C
Greif GEF (10)	1093.3	48	36	NA	4.2	171	23	0.5	NA	2.3	1.32	0.21	2.11*	3.15	10.0	B
Owens-Illinois OI	3108.4	21	76	NM	-75.0	415	NM	0.5	NA	3.0	0.00	-6.89	1.41	1.99	5.0	C
Packaging Corp. of America PKG	2459.1	23	5	NM	4.1	309	77	1.3	12.9	21.9	2.61	-0.14	0.53	1.43	2.0	NR
Pactiv PTV	3683.4	25	4	NM	18.0	381	22	1.1	10.8	1.5	0.00	1.21	1.41	1.60	12.0	NR
Rock-Tenn RKT (9)	573.9	16	-6	NM	2.2	131	60	0.4	6.8	7.5	2.23	0.85	0.27*	1.18	8.0	B-
Sealed Air SEE	4296.1	51	-5	6.9	18.9	349	21	1.2	10.5	1.6	0.00	2.00	2.67	2.98	12.0	NR
Silgan Holdings SLGN	1000.3	54	28	14.2	34.1	522	15	0.4	5.5	2.6	1.10	2.28	4.25	4.41	5.0	B
Smurfit-Stone Container SSCC	4562.1	18	-3	NM	-6.1	207	NM	0.6	15.7	79.8	0.00	-0.85	0.05	1.28	5.0	C
Sonoco Products SON	2783.0	28	16	-16.9	12.5	258	21	0.9	NA	2.3	3.09	0.80	1.56	1.73	8.0	B
Temple-Inland TIN	3336.6	60	-5	-15.2	3.3	159	48	0.7	10.1	3.0	2.42	1.78	3.35	4.48	6.0	B

(D) METALS & MINING

INDUSTRY AVERAGE	6728.7	45	45	2.0	6.7	370	30	1.4	13.0	4.5	1.07	-0.38	3.09	3.76	11.1	
AK Steel Holding AKS	1404.3	13	153	NM	-18.7	460	NM	0.3	9.2	NA	0.00	-5.48	1.32	1.43	NA	C
Alcoa AA	29578.9	34	-11	-3.9	11.1	237	21	1.3	11.4	1.5	1.77	1.20	1.63	2.49	14.0	B+
Allegheny Technologies ATI	2100.8	22	66	NM	-63.5	538	NM	0.9	NM	NM	1.09	-3.87	-0.52	1.18	NA	B-
Arch Coal ACI	2381.4	38	23	NM	13.2	290	20	1.4	8.8	8.3	0.84	0.26	0.84	2.11	5.5	NR
Commercial Metals CMC (8)	1327.5	45	49	30.3c	20.0	201	10	0.3	6.5	NA	0.88	0.66	4.42*	5.79	NA	B+
Consolid Energy CNX	3861.9	43	65	NA	7.0	1003	147	1.5	14.3	5.9	1.31	-0.15	0.82	2.76	8.9	NR
Freeport-McMoRan Copper & Gold FCX	6985.8	39	-7	15.1	-5.4	674	NM	3.7	53.1	5.1	2.56	1.07	0.51	3.29	15.0	B
International Steel Group ISG	4007.2	40	4	NA	26.7	287	11	0.5	7.0	NA	0.00	-1.26	6.26	5.62	NA	NR
Massey Energy MEE	2669.5	35	69	NM	-0.6	346	NM	1.6	12.5	12.2	0.46	-0.43	0.29	1.80	10.0	NR
Newmont Mining NEM	21515.0	47	-3	NM	5.9	281	46	5.2	19.2	8.6	0.84	1.23	1.10	1.46	5.0	B-
Nucor NUE	8415.9	53	89	-26.9	25.7	270	11	0.8	7.1	0.5	0.98	0.40	6.91	5.11	15.0	E
Peabody Energy BTU	5348.7	83	99	NA	7.9	327	39	1.6	13.7	4.5	0.72	0.76	2.61	4.68	7.0	NR
Phelps Dodge PD	9256.5	97	28	NM	18.6	231	13	1.5	7.4	NA	1.03	0.06	10.42	10.52	NA	C
Quanex NX (10)	979.0	59	28	-1.3b	11.8	196	17	0.7	9.1	1.3	1.29	2.62	3.45*	4.03	13.5	B
United States Steel X	5948.4	52	50	NM	27.9	326	12	0.5	6.2	0.7	0.38	-4.09	7.43	6.65	10.0	B-
Worthington Industries WOR (5)	1878.4	22	19	-1.2	19.0	257	14	0.7	9.2	0.6	2.98	1.00	1.90	1.24	18.0	B

(E) PAPER & FOREST PRODUCTS

INDUSTRY AVERAGE	8409.2	42	15	-6.0	9.4	177	24	0.8	7.7	4.8	1.96	0.55	2.48	2.48	5.0	
Bowater BOW	2319.4	41	-13	NM	-6.9	155	NM	0.7	9.8	NM	1.97	-3.52	-0.97	1.94	5.0	B-
Georgia-Pacific GP	9385.7	37	19	-31.8	10.6	156	15	0.5	5.8	2.4	1.37	0.90	3.01	3.14	5.0	B-
International Paper IP	20197.8	42	-4	8.3	4.8	260	55	0.8	10.4	5.7	2.41	0.66	1.45	2.73	5.0	B-
Louisiana-Pacific LPX	2689.3	24	37	11.7	32.7	154	5	0.9	3.8	0.8	1.63	2.67	4.55	1.74	7.0	B-
MeadWestvaco MWV	6808.1	34	13	NM	4.2	142	34	0.8	7.8	13.9	2.73	-0.01	0.81	1.90	3.0	B-



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COMPANY	MARKET CAP	RECENT SHARE PRICE	2003 P/E	E-PINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P/E RATIO	PRICE-SALES RATIO	PRICE CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	ESTIMATES FROM ANALYSTS				
												2003 ACTUAL	2004 ANALYST EST.	2005 CONSENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
AT&T	14559.3	51	46	0.7	7.6	196	25	1.1	9.9	3.6	1.18	1.85	3.48	0.94	4.0	B-
WorldCom	12956.6	66	3	-18.8	13.0	176	13	0.7	6.3	2.2	2.42	1.30	5.05	4.95	6.0	B
TELECOMMUNICATION SERVICES																
INDUSTRY AVERAGE	21228.6	26	1	9.5	18.4	437	25	1.3	29.9	2.8	1.74	5.22	-0.03	0.69	10.2	
TELECOMMUNICATION SERVICES																
INDUSTRY GROUP AVERAGE	21228.6	26	1	9.5	18.4	437	25	1.3	29.9	2.8	1.74	5.22	-0.03	0.69	10.2	
(A) DIVERSIFIED TELECOMMUNICATION SERVICES																
INDUSTRY AVERAGE	24253.9	21	-7	18.9	6.1	237	22	1.2	35.8	3.3	2.18	6.56	-0.47	0.32	7.2	
Alltel AT	17218.2	57	22	8.2	14.5	246	17	2.1	7.5	3.4	2.68	3.05	3.30	3.47	5.0	A-
AT&T T	14559.3	18	-10	-34.7	NM	226	NM	0.5	NM	0.8	5.19	2.36	1.73	1.76	14.0	B
BellSouth BLS	49107.4	27	-5	NA	17.1	225	13	2.4	6.6	4.2	4.03	1.94	1.93	1.61	3.3	A-
CenturyTel CTL	4426.0	33	1	25.7	9.8	130	14	1.8	5.3	4.6	0.70	2.38	2.38	2.32	3.0	A
Cincinnati Bell CBB	882.5	4	-29	208.6	NM	NM	1	0.7	0.8	1.2	0.00	5.02	0.18	0.18	16.0	C
Citizens Communications CZN	4787.8	14	15	-4.5	5.1	346	60	2.2	7.3	7.2	6.99	0.42	0.50	0.45	4.0	C
Global Crossing GLBC	331.1	15	-51	NA	NA	360	NA	0.1	NA	NM	0.00	NM	-18.80	-10.12	NA	NR
IDT IDT (7)	1476.7	15	-34	NM	-9.7	149	NM	0.7	355.2	NM	0.00	-0.22	-1.09*	0.39	NA	NR
Level 3 Communications LVL	2357.7	3	-39	NM	NM	NM	NM	0.6	11.7	NM	0.00	-1.28	-1.00	-1.08	NA	NR
MCI MCIP	5995.3	19	NA	NA	NA	133	NA	0.3	0.3	NM	0.00	68.85	-0.01	0.53	NA	NR
Qwest Communications International Q	7262.5	4	-7	NM	NM	NM	NM	0.5	11.2	NM	0.00	-0.76	-0.60	-0.35	2.0	C
SBC Communications SBC	83449.0	25	-3	-1.7	12.9	208	16	2.1	6.5	3.5	4.97	1.80	1.48	1.27	4.9	B+
Sprint FON	33537.5	23	39	-31.1	-10.4	255	NM	1.2	10.4	1.8	2.19	0.41	0.92	1.39	14.0	B+
Verizon Communications VZ	114164.1	41	18	-19.3	9.3	325	36	1.6	6.7	3.1	3.74	1.27	2.50	2.66	5.4	B
(B) WIRELESS TELECOMMUNICATION SERVICES																
INDUSTRY AVERAGE	10639.8	44	24	-28.3	43.2	989	30	1.6	6.5	1.8	0.21	0.88	1.52	1.97	17.7	
Nextel Communications NXTL	31590.6	28	1	NM	34.9	359	10	2.5	6.4	1.2	0.00	1.36	1.82	1.83	12.9	B-
Telephone & Data Systems TDS	4448.5	78	24	-27.7	3.4	139	42	1.2	5.9	1.6	0.85	1.28	1.74	2.49	28.5	B
U.S. Cellular USM	3821.3	44	25	-28.9	3.5	150	43	1.4	7.2	3.2	0.00	0.87	0.95	1.36	14.6	B-
Western Wireless WWCA	2698.7	27	47	NM	130.9	3306	25	1.5	NA	1.2	0.00	-0.01	1.55	2.20	14.9	C
UTILITIES																
SECTOR AVERAGE	6467.1	33	17	2.5	9.6	186	22	1.0	7.9	4.6	3.43	1.77	2.05	2.28	5.0	
24 UTILITIES																
INDUSTRY GROUP AVERAGE	6467.1	33	17	2.5	9.6	186	22	1.0	7.9	4.6	3.43	1.77	2.05	2.28	5.0	
(A) ELECTRIC UTILITIES																
INDUSTRY AVERAGE	7989.0	36	16	0.2	10.2	189	24	1.1	7.5	4.5	3.91	1.97	2.24	2.55	4.5	
Allegheny Energy AYE	2627.1	19	50	NM	2.9	231	71	0.9	7.6	15.5	0.00	-2.64	0.35	0.85	3.5	C
Alliant Energy LNT	3144.3	27	10	-5.6	7.3	125	15	1.0	5.9	3.0	3.85	1.57	1.82	1.99	5.0	B
Ameren AEE	9432.2	48	5	2.8	8.0	162	18	2.0	9.2	5.8	5.25	3.14	2.77	3.06	3.0	A-
American Electric Power AEP	13520.9	34	12	-15.8	7.2	163	23	1.0	6.9	4.9	4.10	1.35	2.33	2.41	3.0	B
CenterPoint Energy CNP	3434.7	11	15	-29.9	18.0	537	30	0.4	5.4	10.9	3.58	1.37	0.28	0.57	3.6	B
CINergy CIN	7491.4	41	7	-0.7	9.4	198	21	1.6	9.2	4.2	4.54	2.43	2.47	2.90	4.0	B+
Consolidated Edison ED	10605.3	44	2	-6.8	7.3	149	19	1.1	9.7	8.2	5.15	2.36	2.66	2.83	2.0	B+
DTE Energy DTE	7633.3	44	11	-3.6	10.1	139	14	1.1	6.2	3.3	4.69	2.85	2.70	3.55	5.0	B+
Edison International EIX	10393.4	32	45	5.1	2.6	184	69	1.0	8.2	3.6	3.13	2.37	1.77	2.16	5.0	B
Entergy ETR	14600.4	65	13	11.5	7.9	165	21	1.5	8.2	3.4	3.33	3.42	3.79	4.68	5.0	B
Exelon EXC	27634.9	42	26	-5.8	18.2	289	16	1.9	9.2	3.0	3.84	1.21	2.81	3.02	5.0	B
FirstEnergy FE	13929.0	42	20	-13.6	9.2	162	17	1.1	6.3	3.8	3.55	1.39	2.78	2.98	4.0	B+
FPL Group FPL	13052.5	70	8	5.4	11.6	176	15	1.3	6.3	2.8	3.87	5.02	4.95	5.14	5.0	A-
Great Plains Energy GXP	2200.3	30	-7	15.0	11.2	193	16	0.9	7.8	4.5	5.61	2.20	2.22	2.13	3.0	B
Hawaiian Electric Industries HE	2275.9	28	19	1.3	9.7	188	18	1.2	NA	6.0	4.39	1.58	1.70	1.68	2.8	B+
Northeast Utilities NU	2339.8	18	-10	38.3	4.9	101	20	0.4	6.8	3.1	3.57	0.95	1.30	1.18	4.5	B
NSTAR NST	2694.7	51	4	5.4	12.7	189	15	0.9	6.2	2.9	4.38	3.40	3.53	3.64	5.0	B
OGE Energy OGE	2300.1	26	7	-2.0	11.0	180	16	0.5	7.2	5.4	5.15	1.65	1.60	1.69	3.0	A-
Pepco Holdings POM	4010.3	21	9	-25.2	5.5	117	19	0.6	6.4	4.2	4.69	0.63	1.45	1.52	3.5	B
PG&E PCG	13344.5	33	20	1.4	44.4	167	4	1.3	2.6	2.7	0.00	1.96	2.08	2.25	6.0	B
Pinnacle West Capital PNW	4047.5	44	10	-5.6	8.5	136	16	1.4	6.0	5.1	4.30	2.52	2.50	3.18	3.5	A
PNM Resources PNM	1537.6	25	36	-6.6	7.4	138	19	1.0	8.2	3.5	2.52	0.97	1.45	1.56	5.0	B+
PPL PPL	9820.8	52	19	7.3	18.5	236	12	1.7	6.8	2.8	3.16	4.15	3.69	4.04	5.0	B
Progress Energy PGN	10845.8	44	-3	7.3	8.9	142	16	1.1	6.3	3.7	5.24	3.40	3.00	3.62	4.0	A-
Puget Energy PSD	2342.4	24	-1	-12.1	6.8	141	20	0.9	6.5	2.4	4.26	1.22	1.52	1.68	6.5	B
Southern SO	24254.3	33	8	11.2	13.4	235	17	2.1	9.9	3.4	4.36	2.02	2.01	2.08	4.8	A-
Teco Energy TE	2986.0	15	4	NM	-0.3	166	NM	1.1	10.2	4.8	5.08	-0.08	0.78	1.00	4.0	B+
TXU TXU	18326.0	63	165	-2.7	9.8	415	97	1.9	14.0	1.9	3.58	2.03	2.72	5.49	12.0	B
Westar Energy WR	1900.6	22	9	17.1	9.2	145	14	1.3	6.5	6.5	4.15	2.21	1.47	1.68	2.3	B
Wisconsin Energy WEC	3893.5	33	-1	4.0	4.4	160	37	1.1	8.9	2.0	2.52	2.06	2.35	2.39	7.0	B
WPS Resources WPS	1806.5	48	5	10.2	11.2	171	14	0.4	6.8	3.1	4.59	3.24	3.47	3.45	4.5	B+
Xcel Energy XEL	7222.4	18	6	-1.5	10.2	139	14	0.9	6.4	4.1	4.60	1.23	1.25	1.27	3.5	B



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by the parent company of Kraft Foods, Philip Morris International and Philip Morris USA

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ESTIMATES FROM ANALYSTS

	MARKET VALUE	RECENT SHAPE PRICE	2004 PRICE CHANGE %	EARNINGS GROWTH 1999-2003 %	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE- SALES RATIO	PRICE- CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	2003 ACTUAL	2004 ANALYST EST.	2005 CON- SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
(C) MULTI-UTILITIES & UNREGULATED POWER																
INDUSTRY AVERAGE	6300.6	27	20	4.7	8.1	182	21	0.9	8.4	4.9	2.41	1.28	1.78	1.89	6.3	
AES AES	7931.5	12	30	-24.1	19.4	555	28	0.9	NA	1.1	0.00	0.56	0.72	0.78	15.0	B
Calpine CPN	2072.3	4	-19	-8.0	-5.1	45	NM	0.2	5.9	NM	0.00	0.28	-0.62	-0.45	11.0	B
CMS Energy CMS	1651.4	10	20	NM	1.2	94	73	0.3	3.2	4.1	0.00	-0.30	0.82	0.76	3.0	B
Constellation Energy Group CEG	7678.1	44	12	7.0	11.4	159	13	0.7	7.0	1.7	2.61	2.85	3.22	3.38	8.0	B
Dominion Resources D	21670.6	65	3	0.9	14.9	206	21	1.6	7.6	2.3	4.06	2.98	4.71	5.13	6.0	B+
Duke Energy DUK	23712.6	25	24	NM	-6.1	155	NM	1.1	28.1	5.9	4.35	-1.13	1.35	1.46	3.2	B+
Dynegy DYN	2146.5	6	32	5.1a	-5.9	103	NM	0.3	9.0	29.1	0.00	1.30	0.19	-0.14	1.0	C
Energy East EAS	3697.7	25	12	-6.6	8.4	138	16	0.8	7.0	3.7	4.37	1.42	1.68	1.81	4.0	B+
MDU Resources Group MDU	3223.6	27	15	12.6	12.3	200	16	1.2	8.0	1.9	2.64	1.62	1.80	1.94	8.0	A
National Fuel Gas NFG (9)	2340.3	28	15	5.6c	13.3	187	14	1.2	6.6	3.5	3.97	2.31	2.01*	1.89	4.0	B+
Oneok OKE	2885.8	28	26	21.2a	14.7	206	14	0.7	7.5	1.5	3.58	2.21	2.26	2.28	8.0	A-
Public Service Enterprise Group PEG	10456.3	44	0	4.3	14.1	188	13	1.0	7.0	3.4	5.00	3.72	3.19	3.31	4.0	B+
Questar STR	4282.7	51	45	16.7	16.4	325	20	2.5	9.8	2.1	1.69	2.13	2.64	3.29	9.0	A-
Reliant Energy RRI	3547.1	12	61	NA	-0.5	77	NM	0.4	7.8	5.8	0.00	-3.07	0.26	0.35	8.0	NR
Scana SCG	4304.6	38	12	10.1	10.0	176	17	1.2	8.3	3.5	3.81	2.54	2.72	2.82	4.0	B+
Sempra Energy SRE	8616.3	37	23	18.7	18.2	197	10	1.0	5.7	1.6	2.70	3.24	3.21	3.15	7.0	B
Sierra Pacific Resources SRP	1203.7	10	40	NM	-0.7	84	NM	0.4	7.1	8.8	0.00	-1.15	0.39	0.51	3.0	B
Vectren VVC	1989.7	26	6	1.6	10.4	184	18	1.2	8.0	2.4	4.51	1.57	1.55	1.76	7.0	B+

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It's ability, not disability, that counts.

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Annadel Capital (AC) is an RIA firm located in San Rafael and Santa Rosa, CA. Led by principals Gregg Smith and Jed Cooper, AC's purpose is to provide investors the framework they need to make smart decisions. AC uses a consultative approach and subscribes to an institutional process. AC's credentialed staff is well experienced in providing financial services and financial planning. www.AnnadelCapital.com • 415.499.1901



Retirement is no time to get too conservative with your investments

When you think about your retirement, are you concerned about outliving your savings? Are you afraid that health care costs will eat away your retirement income and leave you dependent on your children or charity? Or, are you worried that you may never be able to fully retire? Retiring with confidence means tackling these tough questions *before* you're ready to retire and having a plan in place that makes the most of your retirement savings.

Your first instinct may be to protect your retirement nest egg—to be conservative in your approach so you don't lose what you've saved.

The fact is, there's a good chance you could live 30 years in retirement. That means you'll need to have financial strategies that strike a balance between growing your assets to provide an income stream *and* protecting your savings from the ravages of inflation and market volatility.

A professional financial advisor can help you prepare by developing a solid plan for generating a dependable income in retirement. One such strategy includes using a combination of growth investments, fixed income investments, bonds and annuities to create an "income ladder."

Successful retirement income planning requires a comprehensive understanding of your assets, so start by focusing on what you *have* available for retirement—not what you *don't*. Think about pension plans, 401ks, savings accounts, Social Security income, real estate, and other assets. Then focus on your goals—how active do you want to be in retirement? How much do you want to pass along to your children or a worthy cause? A professional financial advisor can simplify your options to help you enjoy a dependable retirement income once your paychecks stop.

It's never too early or too late to plan. Contact a professional financial advisor and enter retirement with confidence.

To read the full report, go to
www.financial-resource.com/thrivent.asp



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Advanced Investment Technique Provides For Better Retirement

The positive impact of portfolio cost efficiency should not be underestimated.

When portfolio costs are high, you needlessly forego a tremendous real rate of return over your investment time horizon. Seek lower levels of portfolio turnover, taxation and management fees. You will retain more money for long-term appreciation.

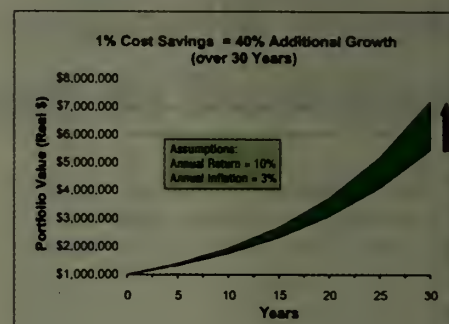
How can you minimize costs in order to preserve your real rate of return? Use separate account management versus mutual funds.

A mutual fund investor holds shares representing a stake in an overall portfolio, but does not actually own the securities in that portfolio.

Mutual funds prohibit portfolio customization and are tax-inefficient because the funds do not consider the investor's individual tax situation when capital gains are distributed.

In contrast, a managed (or "separate") account investor owns the securities held in his/her portfolio. The holdings can be tailored to match his/her unique financial needs. Tax-efficient strategies can eliminate, postpone or reduce taxes.

Compared to mutual funds, separate account management has a distinct competitive advantage: lower annual portfolio costs in turnover (0.25%), taxation (0.40%) and fees (0.35%).



Incremental total annual cost savings of 1% significantly boost your real rate of return by 40% over a 30 year investment time horizon.

Lower your portfolio costs. Retire with more money.

To read the full report, go to
www.financial-resource.com/trivant.asp

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

TriVant Custom Portfolio Group, LLC is a separate account management specialist. The company elevates its clients' portfolio cost efficiency, customization and service. These three areas represent TriVant's competitive advantage and the context of the company name "TriVant". Your needs are unique and you deserve the full benefits of a customized portfolio strategy. If you appreciate special attention and results, TriVant can help. San Diego, CA • 760.633.4022 • www.trivant.com

REITs: Helping to Build the Optimal Investment Portfolio

An asset class with high current yield, significant dividend growth, low historical correlations to other assets, and inflation hedging characteristics may seem too good to be true. It certainly would improve upon one of the most challenging aspects of portfolio management, to minimize volatility while maximizing one's total return potential. The ability to construct an optimal portfolio is easier than you may think. Quite simply, allocating a portion of your portfolio to Real Estate Investment Trusts (REITs) could greatly improve your risk/return profile because of their unique characteristics and diversification benefits.

REITs pay substantially higher yields than the overall equity, treasury and money markets because they must return 90% of their taxable income to shareholders; over the past 30 years, the NAREIT Equity Index has yielded 7.7% on average. Many Wall Street strategists are predicting only moderate returns over the next five years for both equities and bonds. If these forecasts prove correct, then dividends will play a much larger role in the total return of your portfolio. Furthermore, dividend growth from REITs has outpaced inflation, providing a valuable hedge against increasing prices. Not surprisingly, REIT total returns have significantly exceeded the broad equity

and bond markets during this time period.

In addition to the strong relative performance of REITs, their low historical correlation to other assets minimizes portfolio volatility (risk). Modern Portfolio Theory asserts that adding low return, low correlated assets such as REITs, can better optimize your portfolio.

Despite these positive attributes, one must invest wisely by identifying cyclical and secular trends, diversifying geography and property type, and assessing management. Additionally, investors must forecast future cash flows and the company's ability to generate cash flow to estimate the fair value of its property.

In conclusion, building an allocation of quality REITs should greatly improve the long-term prospects for your portfolio.

To read the full report, go to
www.financial-resource.com/stonebridge

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Financial Resource 2005

Investment & Financial Planning Insights

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Can Alternative Investments Help Diversify Traditional Portfolios?

Diversification: it is the cornerstone of modern portfolio theory and has long been recognized by high net worth investors as the foundation of an intelligent investment portfolio. Traditionally, investors have pursued diversification in the form of a mix of stocks, bonds and real estate. Increasingly, sophisticated investors are complementing traditional portfolios with alternative investments, including hedge funds and managed futures, in search of more effective diversification.

Why Diversify with Alternatives? Alternative investments have many unique traits, but can be characterized by their ability to utilize a wide array

of trading techniques often (but not always) including selling securities "short" and employing leverage. Importantly for diversification, however, many of these investments have historically proven to have low correlation with the broader debt and equity markets. Although correlations are by nature subject to change, this means that when traditional investments align, the alternative portion of a portfolio is much less likely to follow. When this alignment occurs in a downward direction, alternative investments potentially provide diversification when it is most needed. (Source: "Implications of the Growth of Hedge Funds", S.E.C., 2003.)

Each Case is Unique. These investments carry their own unique risks – they won't necessarily be suitable for every investor. As well, different alternative investments will provide different levels of diversification. The sheer number of choices (the S.E.C. estimates up to 7,000 hedge funds in the U.S. alone) compounded with the diversity of investment styles and strategies (e.g. currencies, micro caps, commodities, long biased deep value, real estate long/short, market neutral, etc.) underscores the fact that investors need to carefully consider how to best utilize alternative investments. Constructing a portfolio requires in-depth knowledge of each specific investment, thoughtful integration with the existing portfolio, and diligent monitoring. For the right investor and portfolio, these investments offer a very legitimate option for diversification.

To read the full report, go to
www.financial-resource.com/altegris.asp



Altegris is exclusively dedicated to finding unique alternative investments to help high net worth investors and institutions diversify their portfolios. The firm utilizes proprietary research software to gather and analyze quantitative and qualitative data on thousands of hedge funds and CTAs, providing clients with the means to make intelligent portfolio allocations in this complex field. Current clients have over \$1 billion in trading level committed to alternative investments. La Jolla, CA • 800.828.5225 • www.managedinvestments.com

The Case for Long Term Investing in High Quality Growth Stocks

The long term strategy of investing in high quality, industry-dominant companies has proved patient investors with significant returns over the past 75 years. There are approximately twenty five industries represented by the companies traded on major stock exchanges. One hundred years ago we might have viewed very negatively the strong outlook for such industries as railroads, steels and public utilities. In the 1960's we might have talked about the strong outlook for industries such as chemicals and color televisions. However, these industries are now mature and have poorer growth prospects.

It is believed that some of the industries with the best long-term outlooks currently are: (1) communications, (2) consumer non-durables, (3) defense, (4) energy, (5) financial services, (6) health – including biotechnology and services, (7) the Internet, (8) leisure time (9) retailing – including discount and specialty and (10) technology.

In the long run, the strength of the economy and the level of corporate profitability have been key factors in determining the valuations of common stocks. These factors, which are currently positive, are the more important factors at

the present time. Over the long term, interest rates have typically risen during economic expansions and typically the stock market has appreciated.

The probabilities highly favor that investments in a diversified group of industry leading companies that remain industry leaders over the long-term and continue to strongly increase their earnings will build shareholder wealth.

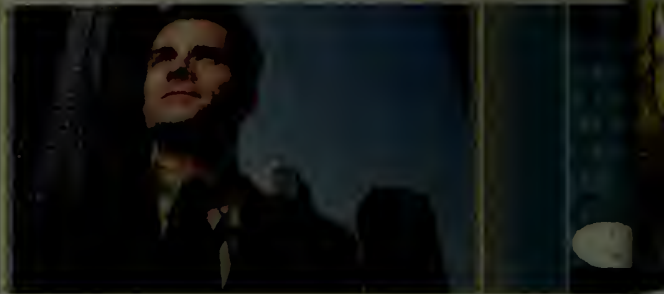
Some of the considerations that should be used in selecting companies for a growth oriented portfolio include revenue growth rates, product innovations, financial strength, management's knowledge and experience plus the overall economic and geopolitical environments and interest rates.

To read the full report, go to
www.financial-resource.com/reynolds.asp

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The Reynolds Funds are a family of no-load mutual funds including the Reynolds Blue Chip Growth Fund, the Reynolds Opportunity Fund, and The Reynolds Fund. The company also manages the Reynolds U. S. Government Bond and Reynolds Money Market Fund. Investors should consider the investment objectives, risks, charges and expenses of Funds carefully before investing. A prospectus contains this and other information about Funds. Read it carefully before investing. 800.773.9665 • www.ReynoldsFunds.com



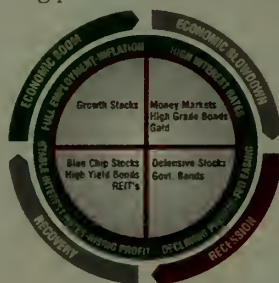


Cash Flow Investing for 2005

To achieve superior long-term investment returns, investors need to focus on the big picture. What is the primary market trend? Do current economic conditions signal a bull market, a bear market, or is it something else?

Investors who owned equities in the 1990's had a wonderful experience, participating in the most powerful bull market in history. But this ride came to an end in early 2000 and was followed by a collapse in stock prices that lasted three years. Bonds and the

safety of money markets were the place to be. What's next – and how do we participate?



A study of market cycles strongly suggests that a sideways or a multi-year range bound market will now dominate the investment environment. Looking out over the next few years, economic growth and higher corporate earnings will be offset by high energy prices, geo-political events, and higher interest rates.

In a market with price swings but no major trend, cash dividends may be the only return for

buy and hold investors. It's no secret that natural resource companies, real estate investment trusts and utility companies were the market leaders in 2004. They are also the best places to search for dividends. Close examination of these industries and individual companies reveals many stocks that yield three to five times the dividend return of major market averages. Also, investors have an additional incentive to emphasize dividends: tax rates on qualified dividends have been reduced to 15%. The tax reduction means that a dollar of dividends is now worth up to 30% more than it was before the tax cut.

For 2005 and beyond, serious investors should be advised to invest for a combination of income and growth.

To read the full report, go to
www.financial-resource.com/rincon.asp



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A Portfolio for the 21st Century

All in all, the U.S. economic outlook for 2005 may be another year of blasé stock market performances and low-yielding fixed-income securities. However, there are other financial markets such as commodities and currencies that now offer excellent investment opportunities.

Up until a few years ago, the foreign currency exchange market was only accessible to large banks and multinational corporations. Now, the onset of the internet age and lower margin requirements have opened up the possibility for the rest of us to participate in this market.

Forex means foreign currency exchange. It is the simultaneous selling of one nation's currency and buying of another nation's currency. Currencies are always traded in pairs, for example Euro / U.S. Dollar (EUR/USD) or U.S. Dollar / Japanese Yen (USD/JPY). The objective of currency trading is simple: to buy the currency that will increase in value relative to the one sold.

The Forex market is the largest financial market in the world trading 24 hours a day with daily volume close to \$2 trillion per day. It is larger in volume than both the U.S. equity and the U.S. bond market combined. Also, trading

in Forex offers the advantage of being able to go long or go short at the same margin level, meaning investors can profit in a bearish market just as easily as a bullish market.

It is no wonder then why the retail Forex brokerage industry is the fastest-growing segment of the financial industry. Investors are realizing the increasing importance in seeing global diversification for their portfolios and currencies are the simplest way to achieve this goal. As an added incentive, most Forex brokers now offer their customers commission-free trading.

So will the Euro continue to make all-time new highs against the U.S. dollar? Or will the greenback make a comeback? It's your call.

To read the full report, go to
www.financial-resource.com/SNC.asp



Located in San Francisco, SNC Investments, Inc. is gaining recognition as one of the leading Forex broker-dealers in the industry. Through its online trading platform, SNC Investments, Inc. is bringing the potential of the Forex market to the personal investor while providing service that exceeds its customer's expectations. San Francisco, CA • 866.SC.FOREX • www.sncinvestment.com

Financial Resource 2005

Investment & Financial Planning Insights

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Niche Investing: Community Bank Stocks

If your grandfather serve on a community bank board of directors, buy the stock in its infancy and pass it on to you? One investor purchased \$20,000 worth of stock 20 years ago in a small Idaho bank that later merged with other banks and eventually became a part of US Bank. His original stock is now worth \$1,000,000. This is a common story – a small, well-managed bank, becomes a bigger holding in your portfolio over time. Often, these banks are under the radar screen of Wall Street analysts and the investment managers who utilize “street research”. Even the volatility of the stock market during the past few years, many investors have abandoned

traditional buy/hold strategies in favor of aggressive, short trading in hopes of making those big returns of the roaring nineties. Some of the most successful investors have been rewarded by the more traditional approach – investing in a special niche that they understand – the small to mid cap financial services universe – community bank stocks with \$100 million to \$8 billion in market capitalization.

Look for banks in areas with fast growing populations and household income better than state or national averages. Oregon and Washington are among the states with populations growing by 20% during the past decade. Oregon banks such

as Cascade Bancorp (ticker symbol: CACB) headquartered in Bend and Columbia River Bank (ticker symbol: CBBO) are examples of small bank success stories. Why? Community banks do a better job of serving small businesses, which remain the keystone of the U.S. economy. According to the Small Business Administration, small businesses employ about 52% of the private work force and create 75% of the new jobs.

There is risk. Many of these stocks are thinly traded. A bank's success is heavily dependent on management and board decisions. Key personnel and the board of directors may, in bankspeak, be a debit or a credit.

Remember – these banks support the vitality of small business and communities and may be excellent investment candidates for growth.

To read the full report, go to
www.financial-resource.com/mcgee.asp



McGee Financial Strategies, Inc. *Purpose + Passion = Performance.* With over 62 years combined experience, the company provides private wealth management to business owners, executives, and retirees. Client focused and results oriented, McGee coaches their clients through the financial seasons of life, utilizing traditional and alternative investments, including small community banks, offered exclusively through Raymond James Financial Services, Inc. Member NASD/SIPC. www.mcgeenet.com

An Ounce of Prevention...

When you identify the single largest threat to your portfolio? The answer is . . . **lawsuits**. Your portfolio is titled in your name, and your assets are **exposed**. If sued, you stand to lose 40% of your wealth – far more crippling than the bear market you will ever face.

This exposure can be eliminated if you make a few simple moves *prior* to any lawsuit (transfers that can be illegal “fraudulent conveyances”). Comprehensive asset protection planning involves two components: 1) maximizing Exempt Assets, and 2) transferring non-exempt assets to Asset Protection Vehicles.

Exempt Assets

Each state protects specific assets in the event of bankruptcy. Examples include: 1) the “homestead exemption,” which protects home equity; 2) spousal assets held in “tenancy by the entirety;” 3) retirement plans; 4) life insurance; and 5) annuities. Maximizing these Exempt Assets offers simple, cost-effective asset protection.

Asset Protection Vehicles

The remainder of your assets should be transferred into one of two Asset Protection Vehicles: 1) Limited Liability Entities, or 2) Asset Protection Trusts. Properly structured Limited Liability Entities can

protect the personal assets of their owners from lawsuits against the entity; and, through the enhanced protection of a “charging order,” they can simultaneously protect the assets of the entity from lawsuits against the owners. **Asset Protection Trusts** rely on the control of a third party trustee as well as a special “spendthrift clause” for their protection. A spendthrift clause specifically prohibits the distribution of trust assets to any creditor of a trust beneficiary. Such trusts can be established for third parties or for oneself, and in certain states or select international jurisdictions.

You have choices; and like investing, you would be wise to diversify among them. Don't delay – undergo an **Asset Protection Audit** and eliminate your exposure... before it's too late.

To read the full report, go to
www.financial-resource.com/duggan.asp



ANDLER, THAYER & DUGGAN, LLC
ATTORNEYS AND COUNSELORS AT LAW

James M. Duggan, MBA, JD, is a principal of Handler, Thayer & Duggan, L.L.C., a Chicago-based law firm concentrating on business law, estate planning, taxation, and asset protection, particularly as they pertain to high net worth clients. The firm is recognized nationally for its leadership in the areas of asset protection and tax minimization. 312.641.2100 • www.htdlaw.com.





Harold manages growth portfolios. Phil manages value portfolios.
They only meet at the watercooler.

Name of Fund	Fund Category	1 Yr.	5 Yrs.	10 Yrs./Life of Fund	Inception Date
New Opportunities II ^{††} (ANOIX)	Small Growth	20.54%	—	— / 6.77%	6/1/01
Vista SM (TWCVX)	Mid-Cap Growth	16.79%	7.56%	8.89% / 10.34%	11/25/83
Value [†] (TWVLX)	Mid-Cap Value	19.56%	9.25%	13.08% / 12.45%	9/1/93
Equity Income (TWEIX)	Mid-Cap Value	17.22%	10.61%	14.34% / 14.37%	8/1/94

Average annual total returns as of 9/30/04

Data presented reflect past performance. Past performance is no guarantee of future results. Investment return and principal value will fluctuate, and redemption value may be more or less than original cost. To obtain performance data current to the most recent month end, please call 1-877-442-6236 or visit americancentury.com. Performance reflects Investor Class shares. For information about other share classes available, please consult the prospectus. Data assume reinvestment of dividends and capital gains. American Century Investment Services, Inc., distributor.

[†]Available exclusively through investment professionals.

^{††}Historically, small-cap stocks have been more volatile than the stock of larger, more established companies.

As a company, our sole focus is managing money. In turn, each of our portfolio management teams concentrates on only one discipline. As specialists, they each live, eat and breathe their distinct investment process. And their expertise helps us deliver long-term performance that seeks to exceed industry benchmarks. Our investments stay true. Because our people do the same.



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You should consider a fund's investment objectives, risks, and charges and expenses carefully before you invest. The fund's prospectus, which can be obtained by calling 1-877-442-6236, contains this and other information about the fund, and should be read carefully before investing.

BY ROBERT BARKER

Kellogg: A Little Payoff In the Box?

With breakfast cereal, is there more value inside the box or on the outside? Don't laugh. At my local market, 10.5 ounces of Shur Fine corn flakes cost \$1.69. The same size box of Kellogg's Corn flakes costs \$3.69, 118%

more, although the Kellogg's package does feature pictures of Aladdin and the Genie. The corn flakes come as a bonus.

If there are limits to how hard a company can sell packaging over product, Kellogg is stretching them. Right now, it's pushing a "Limited Edition" multigrain cereal called The Incredibles (10.5 ounces for a \$2.79 box), part of a joint promotion with Walt Disney and Pixar, makers of the hit movie of the same name.

With new frontiers in marketing—a key element in outgoing CEO Executive Carlos Gutierrez' strategy—have helped boost revenue 5.3% this year, not counting currency moves. Better margins as cost cutting widens margins, full-year profits should be \$2.12 a share, up 10% or so from 2003. Since Gutierrez became chairman in April, 2000, the stock has doubled.

WONDER, THEN, that the share price began wobbling after President George W. Bush named Gutierrez his next Commerce Secretary. Yet this may be an overreaction, because Kellogg has plenty of substance within, whoever's face is on the corporate package. New CEO James Jenness, who joined Kellogg's board in 2000, is making it plain he plans to stay on Gutierrez' course. More important, the company has the

means to reward investors further. Kellogg has ample room to raise its dividend, and I'm betting it will before long.

To see why I'm optimistic about Kellogg's payout, let's look closer at the Battle Creek (Mich.) company. It's still the world's largest cereal maker. Yet Kellogg is also selling lots of foods for other times of the day. Not only is it the maker of



FACE VALUE

Such gimmicks are signature Kellogg

Morningstar Farms-brand meat substitutes (think veggie burgers), but it also paid \$4.6 billion in 2001 to buy cookie giant Keebler. Kellogg borrowed heavily to swing the deal, and the burden of paying a much bigger interest tab put an end to its annual custom of raising the dividend.

Now, more than four years since Kellogg last hiked the payout, its balance sheet looks like it has been dining on Special K. Debt, which topped more than \$6.2 billion at the end of 2001 and made up 88% of capital, had been worked down to less than \$4.9 billion, or 72% of capital, by Sept. 30 this year. Meantime, Kellogg's free cash flow—cash from operations, minus capital spending—is surging. In 2002, the year Kellogg's interest expenses peaked, free cash flow came to \$746 million. This year the company expects free cash flow of \$925 million to \$1 billion. Assume the midpoint of that range, and Kellogg is set to pay out 43% of its 2004 free cash flow. Before buying Keebler it paid out 62% (chart).

So where has the extra dough gone? Kellogg has used it to pay back some borrowings—an estimated \$300 million this year—and to fund \$300 million worth of stock repurchases in 2004. For next year, Kellogg has budgeted an additional \$400 million for buybacks. But those aren't the only uses Kellogg's board has in mind. A spokesman told me the board aims to use free cash flow in a balanced program of debt reduction, share repurchases, acquisitions—and an attractive dividend yield. It's well on its way toward the first two items in that program. As for the third, it's a risk. Dealmaking continues in the packaged foods industry—witness Wrigley's recent agreement to buy several candy lines from Kraft Foods—and Kellogg certainly could blow its fresh liquidity on another major acquisition.

Yet with Kellogg shares near \$43, its current \$1.01 annual dividend makes for a 2.3% yield. Kraft yields 2.3%, General Mills 2.6%, H.J. Heinz 3%, and Sara Lee 3.3%. Suppose Kellogg wants to get nearer, say, to General Mills's 2.6% yield. What would it cost? A manageable \$53 million or so. It could be a special bonus inside the box. ■

E-mail: rb@businessweek.com

HIGHER DIVIDEND DUE?

KELLOGG STOCK DIVIDENDS AS PERCENTAGE OF FREE CASH FLOW



Source: Company reports, BusinessWeek estimate

BusinessWeek online

For a Q&A with Kellogg CEO James Jenness, go to www.businessweek.com/extras

ALL HYBRIDS ARE NOT
CREATED EQUAL.



HYBRID

Unlike the competition's mild hybrids, which always require power from the gasoline engine, full hybrids – like the new Ford Escape Hybrid – have the ability to drive in electric-only mode at certain speeds. That means fewer trips to the gas station. 61% fewer smog-forming pollutants. 80% better fuel economy.* In fact, this SUV is the most fuel-efficient SUV out there. No, all hybrids are not created equal. On the road to a better future, some are born to lead the way. Fordvehicles.com/escapehybrid.



ESCAPE HYBRID

Earth's First Full Hybrid SUV.

*Improved fuel economy and emissions data compared to Escape gasoline engine. Escape Hybrid EPA estimated 36 city/31 hwy mpg, front-wheel drive. Your actual mileage will vary depending on your driving habits.



BY GENE G. MARCIAL

VERIZON'S ROVING EYE MAY FALL ON RURAL TELECOM ALLTEL.

INTEROIL LOOKS READY TO STRIKE IT RICH IN PAPUA NEW GUINEA.

E-COMMERCE GROWTH IS BOUND TO BOOST KEYNOTE SYSTEMS.

Alltel: Expecting a Call?

NOW THAT SPRINT has agreed to buy Nextel, one outfit wired as the next takeover, some say, is Alltel (AT), a Little Rock provider of telecom services, mainly in small towns and rural markets. "Its widely used CDMA [code division multiple access] wireless technology makes it a natural target for Verizon—also a user of CDMA," says Tavis McCourt of investment firm Morgan Keegan. Verizon, he says, would profit from its "substantial customer base and extremely profitable operations." Earlier, Verizon was rumored to be interested in Sprint, but a Verizon-Sprint deal would have faced tough going with regulators, as the duo would control nearly 40% of the wireless market. Now, Alltel is the largest asset left to buy. Acquiring Alltel, with its 8.4 million subscribers, would boost Verizon (with 42 million) to a 32% market share, making it No. 1. Cingular is now tops, with 46 million. (Sprint-Nextel will have a combined 34 million.) Verizon and Alltel already have close ties: Alltel lets Verizon offer its subscribers roaming access to its rural network, and Alltel, in turn, offers Verizon's national services to its users. The stock, now at 58.25, is worth 70 in a buyout, says McCourt. David Barden of Banc of America Securities, who rates Alltel a buy, figures it will earn \$3.31 a share in 2004 and \$3.55 in 2005, vs. \$3.05 in 2003. Alltel and Verizon declined comment.



InterOil: Hot Prospects In the South Pacific

LITTLE-KNOWN InterOil (IOC) has gushed from 14 on Sept. 1 to 36.25 on Dec. 15. Sure, oils have been hot, but InterOil is an intriguing play: The Canadian company is building an energy business in Papua New Guinea. It operates Papua's only commercial refinery and owns retail and wholesale outlets (mostly acquired from British Petroleum). It's also exploring for oil over 8.8 million acres. The distribution and refining business alone is worth the price of the stock, says Wayne Andrews of investment bank Raymond James & Associates, which has done business with InterOil. He rates it a strong buy. But the main reason to own the stock, says Andrews, is InterOil's oil prospecting. It has identified 10 sites in Papua that, he says, show unproved

resources with a potential of 4.5 billion barrels. He sees InterOil in the black in 2005, earning \$1.30 a share on sales of \$545 million, compared with a loss in 2004 on \$291 million. Joe Hill of Imperium Capital Management, which owns 2%, says InterOil's initial drilling in 2003 showed "encouraging results." His 12-month price target: 70.

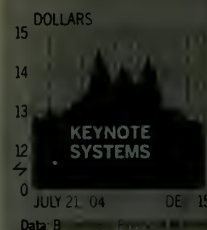
SPOUTING RIGHT UP



Web Players Need What Keynote Has

INTERNET STOCKS are back, but not Keynote Systems (KEYN). Keynote measures how well a company's Web site performs in attracting and servicing customers. Clients include Yahoo!, Hewlett-Packard, and American Express. The stock is down from nearly 15 in September to 12.60 on Dec. 15. The reason: its strong cash flow enabled it this year to make two acquisitions—which usually causes selling of shares, at least initially. But to John Buckingham of Al Frank Asset Management, which owns shares, Keynote is an eye-catching "value play with long-term growth prospects in a sexy industry." With no debt and a cash stash of \$148 million, or \$7.50 a share even after the two acquisitions, investors are paying just \$5.50 for Keynote's business, says Buckingham. There's a further \$30 million, or \$1.50 a share, he adds, from its real estate. And he sees earnings growing to 28¢ a share for the year ending Sept. 30, 2005, and to 40¢ in fiscal 2006, up from 22¢ in 2004. Eric Martinuzzi of Craig Hallum Capital Group, who rates Keynote a buy, says the pickup in earnings is partly driven by Keynote's consulting business that advises companies on how to keep online customers from defecting to rival sites. CEO Umang Gupta, who owns 10% of the stock, says this part of the business, now 35% of sales, has produced high margins and has grown rapidly. ■

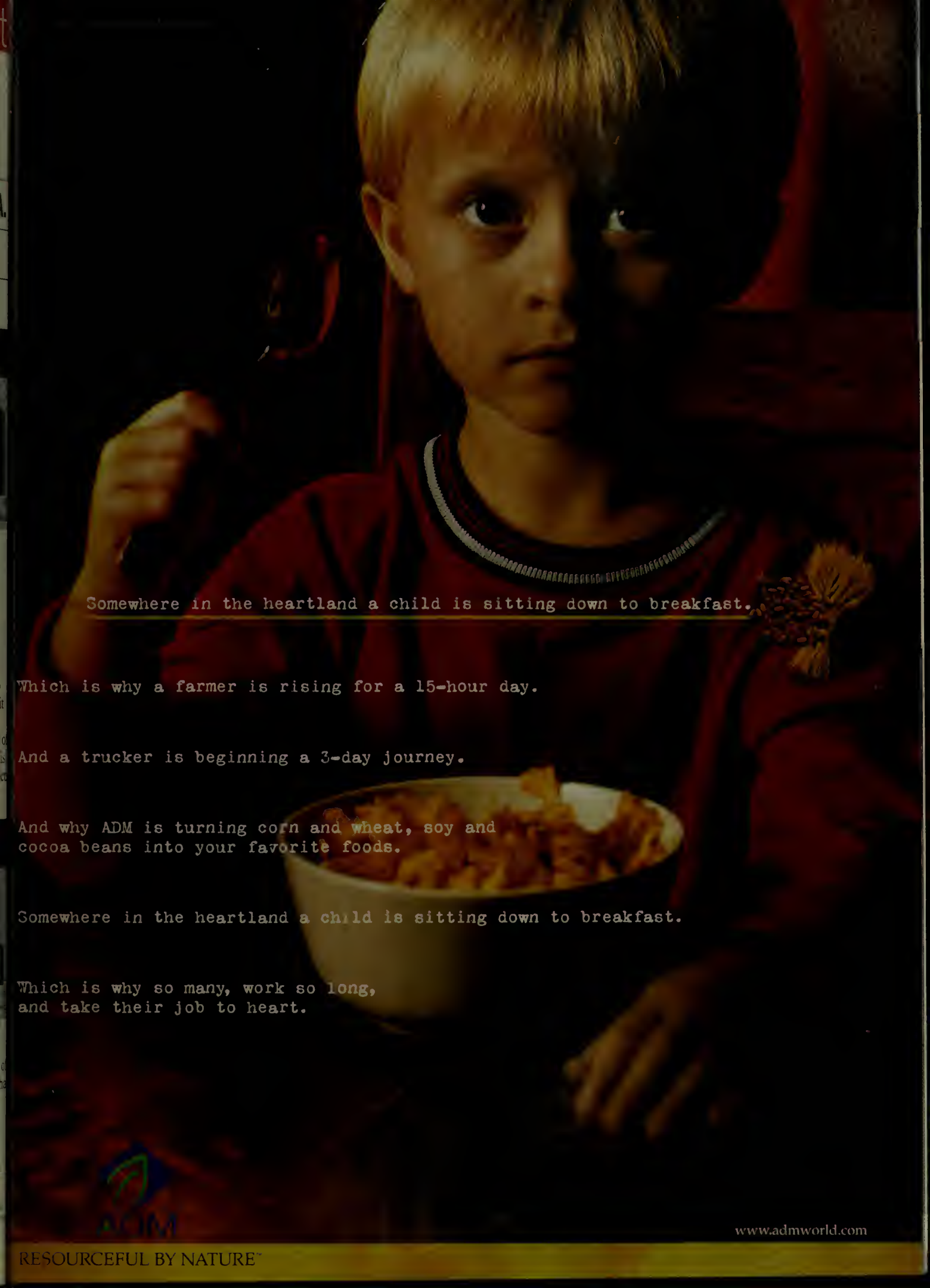
DOWN BUT HARDLY OUT



BusinessWeek online

Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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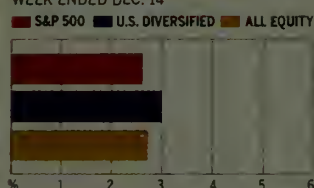
COMMENTARY

Nothing could stop stocks this week—all the major indexes finished at their year-to-date highs. Investors brushed aside the Fed's latest quarter-point rate hike and are learning to shrug off the ups and downs of oil prices. Also, merger activity is heating up: Sprint is acquiring Nextel in a \$35 billion deal that has investors scouring the market for the next hot sector.

Data: Bloomberg Financial Markets, Reuters

MUTUAL FUNDS

4-WEEK TOTAL RETURN WEEK ENDED DEC. 14



52-WEEK TOTAL RETURN WEEK ENDED DEC. 14



Data: Standard & Poor's

U.S. MARKETS

	DEC 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1205.7	1.9	8.4	12.9
Dow Jones Industrials	10,691.5	1.9	2.3	6.7
NASDAQ Composite	2162.6	1.7	7.9	12.7
S&P MidCap 400	655.9	2.9	13.9	17.4
S&P SmallCap 600	326.1	2.5	20.6	24.7
DJ Wilshire 5000	11,868.2	2.1	9.9	14.3

SECTORS

			% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
BusinessWeek 50*	700.0	1.4	12.5	16.2
BW Info Tech 100**	368.6	0.8	5.2	9.7
S&P/BARRA Growth	581.6	1.8	4.6	8.4
S&P/BARRA Value	619.7	2.1	12.3	17.5
S&P Energy	288.0	2.4	28.5	38.5
S&P Financials	407.7	2.1	7.3	11.8
S&P REIT	143.7	1.4	24.1	25.6
S&P Transportation	240.5	-0.1	19.1	20.1
S&P Utilities	139.8	2.9	18.1	23.7
GSTI Internet	177.7	6.6	22.8	30.8
PSE Technology	777.3	1.6	11.5	16.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	DEC. 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1363.1	1.9	15.6	20.7
London (FT-SE 100)	4728.2	0.5	5.6	8.7
Paris (CAC 40)	3803.0	0.7	6.9	9.1
Frankfurt (DAX)	4213.7	0.3	6.3	8.7
Tokyo (NIKKEI 225)	10,956.5	0.1	2.6	6.1
Hong Kong (Hang Seng)	14,078.5	0.4	11.9	14.8
Toronto (S&P/TSX Composite)	9106.2	1.1	10.8	14.7
Mexico City (IPC)	12,493.9	3.1	42.1	49.8

FUNDAMENTALS

	DEC. 14	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.92%	1.95%	1.61%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.3	19.8	27.0
S&P 500 P/E Ratio (Next 12 mos.)*	16.8	16.6	18.1
First Call Earnings Revision*	-0.27%	-0.21%	-0.43%

*First Call Earnings

TECHNICAL INDICATORS

	DEC. 14	WEEK AGO	YEAR AGO
S&P 500 200-day average	1124.6	1123.4	Positive
Stocks above 200-day average	77.0%	74.0%	Negative
Options: Put/call ratio	0.66	0.62	Neutral
Insiders: Vickers NYSE Sell/buy ratio	6.35	6.26	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Home Entertainment	20.6	Internet Retail	105.6
Fertilizers & Ag. Chems.	15.1	Fertilizers & Ag. Chems.	86.7
Constr. & Engineering	14.1	Internet Software	81.2
Comptr. Stge. & Perphs.	13.9	Steel	77.2
Insurance Brokers	13.8	Oil & Gas Refining	70.8

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
IT Consulting	-10.6	IT Consulting	-32.1
Specialty Appar. Retailers	-9.9	Insurance Brokers	-21.1
Hypermkts. & Suprcntrs.	-7.6	Semiconductor Equip.	-19.1
Aluminum	-7.4	Semiconductors	-17.1
Gold Mining	-6.4	Aluminum	-10.1

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	7.0	Latin America	41.3
Europe	4.1	Natural Resources	34.3
Health	4.0	Real Estate	31.3
Technology	3.9	Communications	28.8
LAGGARDS		LAGGARDS	
Precious Metals	-8.2	Precious Metals	-3.8
Japan	-2.5	Technology	7.9
Diversified Pacific/Asia	-0.4	Domestic Hybrid	9.5
Pacific/Asia ex-Japan	0.6	Japan	10.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Fidelity Sel. Mdcl. Del.	12.9	Profds. Wrllss. Ultsr. Inv.	88.5
iShares MSCI Austria Idx.	10.9	iShares MSCI Austria Idx.	72.7
Apex Mid Cap Growth	10.6	ProFunds Energy Ustr. Inv.	56.7
Oberweis Micro Cap	10.1	Bruce	54.2
LAGGARDS		LAGGARDS	
ING Russia A	-14.8	Ameritor Investment	-35.3
PFds. Pr. Mtls. Ustr. Inv.	-12.4	Rydex Dyn. Vent. 100 H	-31.7
Third Millennium Russia	-10.7	ProFunds UltSh. OTC Inv	-31.7
Rydex Precious Metals	-10.7	Thurlow Growth	-31.6

INTEREST RATES

KEY RATES

	DEC. 15	WEEK AGO	YEAR AGO
Money Market Funds	1.61%	1.56%	0.67%
90-Day Treasury Bills	2.21	2.24	0.89
2-Year Treasury Notes	2.94	2.90	1.81
10-Year Treasury Notes	4.07	4.12	4.19
30-Year Treasury Bonds	4.71	4.78	5.03
30-Year Fixed Mortgage †	5.61	5.62	5.75

†BankQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.55%	4.54
Taxable Equivalent	5.07	6.49
Insured Revenue Bonds	3.69	4.61
Taxable Equivalent	5.27	6.61

THE WEEK AHEAD

LEADING INDICATORS Monday, Dec. 20, 10 a.m. EST » The Conference Board's November index of leading economic indicators is expected to have improved by 0.2%, after five consecutive monthly declines. That's according to the median forecast of economists surveyed by Action Economics.

DURABLE GOODS ORDERS

Thursday, Dec. 23, 8:30 a.m. EST » New durable goods

orders during November probably rebounded with a 0.5% gain, following a broad-based 0.4% decline in October.

PERSONAL INCOME

Thursday, Dec. 23, 8:30 a.m. EST » November personal income is forecast to have increased by 0.3%, following a solid 0.6% gain in October. Consumer spending probably rose by 0.3%, after a 0.7% jump during the prior period. Last month's smaller gain in

outlays was due in part to weaker auto sales.

NEW RESIDENTIAL SALES

Thursday, Dec. 23, 10 a.m. EST » New single-family home sales most likely inched down to an annual pace of 1.22 million in November, from an annualized rate of 1.23 million in October. New home sales are currently on track to reach a total of 1.19 million this year. It would mark a fourth straight record year for sales.

The BusinessWeek production index improved to 232.8 for the week ended Dec. 4, up 10.2% from a year ago. Before calculation of the four week moving average, the index surged to 235.5.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra

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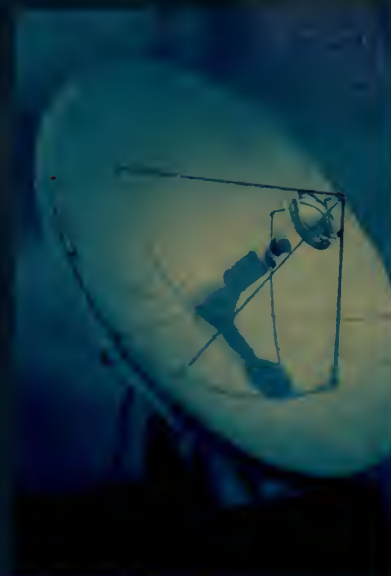
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DEFINING THE FUTURE

SAN DIEGO

INHERITS THE FUTURE ►



The smart money says San Diego's economy may be almost as perfect as its weather. Consider some of the milestones of 2004. In April, the Padres major league baseball team played its first home game at the new \$450 million Petco Park — the latest catalyst for development in an already booming downtown. In June, the Milken Institute named San Diego the top biotechnology center in the country, outranking Boston's Route 128 and Silicon Valley. In October, Sony Electronics moved its U.S. corporate headquarters to San Diego from New Jersey, a major coup. The San Diego area enjoys low unemployment and actually added jobs during the recent national recession, and the region's employment is forecast to grow 34% between 2000 and 2030. No wonder the downtown skyline is dotted with construction cranes, a harbinger of bustling office towers, residential and commercial lofts, and condos with sublime waterfront views.

The city's reputation as a mecca for technology, biotech, and telecom is well-deserved. Roughly 1 in 10 San Diegans works in technology — twice the national rate. From entrepreneurial startups to multinationals, San Diego companies are creating innovations to cure cancer, play movies over your cell phone, and even prevent snoring. Its 500 biotech companies comprise the nation's most concentrated life sciences cluster, generating \$5.8 billion in revenue a year. To supply this demanding set of employers, the area's leading universities — the University of California at San Diego, the University of San Diego, and San Diego State University — turn out a highly skilled workforce every year. Research centers such as the Salk Institute for Biological Studies and the Scripps Research Institute are a magnet for top talent.

"San Diego's economic strength is rooted in a spirit of cooperation that brings business, government, and academia together to develop

strategies for continued growth," says San Diego Mayor Dick Murphy. "This cooperation has created a level of innovation, entrepreneurship, and economic development that sets us apart."

A CULTURE OF INNOVATION

Over the past few decades, San Diego's academic leadership has been busy propelling discoveries from the lab to the global marketplace. The alumni, faculty, and staff from UCSD alone have spun off about 220 companies, including communications company Linkabit in 1968 and wireless giant Qualcomm Inc. in 1985. San Diego's first biotech company, Hybritech Inc., was founded in 1978. "In the last 25 years, the seeds were planted for San Diego's global leadership in industries like life sciences and telecommunications, and they

SAN DIEGO

HERITS THE FUTURE ▶

dominated in the 1990s," says Julie Meyer Wright, president and CEO of the San Diego Regional Economic Development Corp. (EDC). "By the close of the century, San Diego was recognized for being on the cutting edge of these 21st-century industries that continue to drive growth and innovation."

Moreover, the area's startups have proved to be a magnet for global players that are chasing the next big thing. Consequently, venture capital investment is on the rise. "We're working with venture capital firms to spur continuing growth in emerging technologies," says Hank Cunningham, director of community and economic development for the City of San Diego. "Small and emerging businesses are really the backbone of our economy."

Diego's economy boasts an \$18 billion defense component. Industry leaders include Cubic Corp., General Atomics, National Steel and Shipbuilding Co., Northrop Grumman Corp., Science Applications International Corp., and Titan Corp.

One company on a hiring spree in San Diego is Los Angeles-based Northrop Grumman. The \$29 billion defense company — one of the nation's three largest — is recruiting top engineering talent to play a crucial role in advancing the high-tech transformation of the nation's military. Northrop Grumman, a 25-country multinational, has grown to 4,300 employees in San Diego and expects to hit 5,000 by the end of 2005. A new 200,000-square-foot San Diego campus is set to open next spring.

Once strictly a military aircraft manufacturer, Northrop Grumman has capitalized on post-Cold War consolidation to make strategic acquisitions, three with a significant presence in the San Diego area alone. Locally, the company now designs unmanned aircraft, repairs and maintains ships for the U.S. Navy and Marine Corps, and develops radio systems for next-generation military aircraft.

Northrop Grumman's San Diego-area acquisitions were Ryan Aeronautical in 1999, Newport News Shipbuilding in 2001, and TRW in 2002, all of which directly contributed to the region's rich aerospace and naval heritage. Ryan built the Spirit of St. Louis in San Diego for Charles Lindbergh's historic transatlantic flight in 1927. The unmanned systems business, consisting mainly of legacy Ryan business, is Northrop Grumman's fastest-growing unit in San Diego. The company's unmanned aerial vehicle (UAV) fleet includes the Global Hawk, a high-altitude spy plane already deployed by the U.S. Air Force in Iraq, and the Fire Scout, which provides situational awareness and precision targeting support. And the Hunter, equipped with electro-optical infrared sensors, recently began recon-

Driving San Diego's Growth

Key industries driving growth along with telecom and defense:

BIOTECHNOLOGY & LIFE SCIENCES

Biotech is booming, thanks to recent IPOs, growing venture capital investment and \$300 million in voter-approved annual funding for stem cell research in California over the next decade, according to Joe Panetta, president and CEO of industry organization Biocom. Leading companies include Amylin Pharmaceuticals Inc., Biogen Idec Inc., Invitrogen Corp., Johnson & Johnson, Merck & Co., Neurocrine Biosciences Inc., Novartis, and Pfizer Inc.

SOFTWARE & INTERNET

Approximately 600 software and Internet companies represent one of the top technology payroll industries in the region, according to Bob Slapin, executive director of the San Diego Software Industry Council. Industry leaders include Document Science Corp., Fair Isaac Corp., Intuit Inc., Peregrine Systems Inc., and Websense Inc.

COMPUTERS & ELECTRONICS

With more than 370 companies, San Diego's computers and electronics sector often takes advantage of maquiladora factories just south of the border in Mexico. Global brands include Hewlett-Packard, Samsung, Sanyo, and Sony.

TOURISM & VISITOR INDUSTRY

Seaside San Diego is known for attractions like the San Diego Zoo and Wild Animal Park, SeaWorld San Diego, and Legoland California. In 2003, the region's 26.4 million visitors spent \$5.3 billion, according to the San Diego Convention & Visitors Bureau.

INTERNATIONAL TRADE

On the edge of the Pacific Rim and next door to Latin America, San Diego is a growing center for international trade — accounting for as many as 145,000 jobs in San Diego, according to Bella Heule, president and CEO of the San Diego World Trade Center.

▶ NORTHROP GRUMMAN'S FIRE SCOUT HELICOPTER IS ON THE ALERT.

The city leaders wish to leave no opportunity unturned. UCSD Connect, an organization set up to foster the entrepreneurial spirit in technology and the life sciences, facilitates the search to find areas of common interest and mutual benefit, an effort that continues to pay off for area businesses. "San Diego is a very collaborative community," says Duane Roth, UCSD Connect's executive director.

THE MILITARY TECHNOLOGY COMPLEX

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SAN DIEGO

INHERITS THE FUTURE

resource fights for the Department of Homeland Security along the Arizona-Mexico border. "Our goal is to be the most trusted supplier of systems and technology in the defense business, for any service," says John Pettitt, Northrop Grumman's lead corporate executive overseeing San Diego. "And in San Diego, we want to be the preferred employer."

TALK TO ME

In addition to its robust defense business, San Diego could be called the wireless capital of the world. Its 300 telecom

which commercialized Code Division Multiple Access (CDMA), now a global standard in cell phone technology.

Today, LG Electronics enjoys the largest share of the CDMA mobile device market in the U.S. and globally, providing nearly one of every four CDMA devices sold worldwide. LG also recently began making GSM (Global System for Mobile) handsets. The largest U.S. wireless carriers market LG phones, including Verizon Wireless, Sprint PCS, and Cingular Wireless. The company is becoming even better known to U.S. consumers, as it began airing its first national TV ads

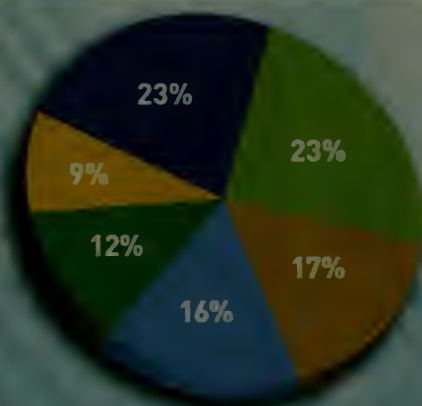
speed EV-DO and EDGE capabilities, integrated megapixel cameras, Bluetooth compatibility, sliding form factors, and stereo sound without compromising quality and functionality," says Juno Cho, president of LG Electronics MobileComm USA.

San Diegans agree that LG's tag, "Life is Good," would be an equally accurate motto for their region's business climate, with its perfect weather, highly educated pool of prospective employees, and a shared enthusiasm for making 21st-century industries feel welcome. "Some of our driving industries are beginning to add jobs more rapidly now," says Marney Cox, chief economist for the San Diego Association of Governments. "We expect biotech and telecom to lead the way for further job growth in San Diego." By all accounts, it looks like life in San Diego is only going to get better. ■

LG'S VX8000
CAMERA PHONE:
A FLAGSHIP
PRODUCT.

San Diego's Booming Technology Sectors

About 1 in 10 San Diegans works in technology—twice the national average.



Percentage of Tech Employment

- Biosciences
- Telecommunications
- Defense
- Computers & electronics
- Software
- Environmental technology

Source: San Diego Association of Governments

companies are "redefining the face of communications," says Julia Wilson, CEO of the San Diego Telecom Council. Some of the hottest innovations: ultra-wideband solutions for faster Web surfing and WiFi products that enable laptop users to check their e-mail wherever they are. Leading area telecom players, in addition to Qualcomm, include Ericsson, Kyocera Wireless, LG, Motorola, Nokia, and Siemens.

Wireless is another example of success breeding more of the same. Korea-based LG Electronics Inc., a \$30 billion player, founded LG Electronics MobileComm USA, one of its U.S. subsidiaries, in San Diego in 1998. The key attractions, according to LG executives, were a highly skilled workforce and proximity to partners such as Qualcomm,

this year, with the tagline "Life is Good." Says Michael Ahn, president and CEO of LG Electronics USA: "Our new multi-million-dollar branding and advertising campaign highlights how mobile handsets are changing and enriching the lives of consumers around the world."

More than just phones, LG makes sleek, stylish entertainment devices that offer the latest in cutting-edge technology. In 2005, LG's VX8000 camera phone will be the company's flagship product for the launch of Verizon's blazing fast Evolution Data Optimized (EV-DO) network, downloading streaming music and movies at speeds comparable to a broadband Internet connection. "In 2005, LG will remain at the forefront of mobile handset development, offering consumers new technologies like high-

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LG Electronics MobileComm USA Inc.
<http://www.lgusa.com>

Northrop Grumman Corp.
<http://www.northropgrumman.com>

City of San Diego
<http://www.sandiego.gov/ced>

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Photo by Mandy Patterson Hawkins Productions

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What makes cities possible?

Air conditioning to make us comfortable.

Jets from city to city.

Elevators that allow us to build our dreams.

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Savvy Investments for A Year Full of Surprises

THE NEW YEAR IS UPON US, and it's time to think about investing in 2005. Making serious money will require playing through a complex series of interest-rate, currency, and electoral cycles. Knowing how to arbitrage cost imbalances in the global economy will help as well. Investors will have to distinguish between near-certainties (the dollar will fall; interest rates will rise) and worrisome uncertainties (the shape of Social Security reform and events in the Middle East). Surprises abounded in 2004. We can expect no less in the new year.

Here is what to look for in 2005:

CASH. With interest rates probably entering a rising cycle, companies with strong balance sheets, low debt, consistent earnings, and plenty of cash on hand are bound to outperform. Look for companies repatriating big earnings from abroad as well. They will pay only 5.25% in taxes on billions of dollars in profits. Look, too, for companies paying dividends. They did better than nondividend-paying companies in 2004 and will probably do so again next year. With earnings growth expected to be in the single digits in 2005, dividends will offer an added kick to overall returns. And the reelection of George W. Bush almost guarantees that the capital-gains and dividend tax cuts passed in his first term will be made permanent in his second. When people face paying an income tax rate of up to 35% on savings or 15% on dividends, they'll choose dividends. General Electric Co. and Boeing Co. just raised their dividends. Follow the money.

THE DOLLAR. If history is any guide, the dollar has at least another year to go in its descent. One look at the yawning current account deficit should tell you that there could be an additional 10% to 15% decline before the trade gap begins to close substantially. That means U.S. multinationals that generate 30% or more of their earnings abroad should do well in 2005. Look especially for companies with large operations in Europe and Japan. The dollar is falling most sharply against the euro and the yen. Shifting asset allocation to invest more in German, French, and Japanese companies also makes sense. And if Beijing decides to revalue the yuan, investors in highly profitable Chinese companies could get a windfall.

POLITICS. Wall Street is pumping out stories on how to play the Bush reelection, but investors should be cautious. Even if Congress passes a bill partially privatizing Social Security in 2005, it will probably take two or three years to set up 100 million private accounts and several additional years for them to amount to much. Investment options will initially be limited to a half-dozen low-fee index funds. So low-cost financial-service firms are more likely to get the Social Security private account business. Wall Street's prominent brokerage firms, however, should profit much sooner from health savings accounts that are already spreading throughout Corporate America. Bush made them legal in his first term and promises to sweeten them with more tax breaks in his second. HSAs are likely to be modeled after 401(k)s, with many investment options and more business for Wall Street.

MARKETS. Investors will need to be nimble in 2005, moving into segmented markets. The Hispanic market is booming, and companies successfully selling into it are profiting. Media, financial, and health-care companies that

Companies paying dividends look good. So does the M&A market

target Hispanic consumers should do well. Tax breaks, energy worries, and global warming are making nuclear, wind, and solar energy increasingly important markets. The so-called BRICs—Brazil, Russia, India, and China—are growing much faster than Europe, Japan, and the U.S. Investing in them means playing the outsourcing and offshoring game, arbitraging the cost differences within the

global economy. Russia, of course, is almost a pure energy play, so caution is warranted.

The mergers-and-acquisitions market could take off in 2005 as companies deploy their billions in cash holdings. The yearend burst of M&A activity may be a harbinger of lots more action to come, providing expanding opportunities for investors. Look for consolidation in software, telecom, textiles, retail, and high tech.

No one, of course, can predict what next year's surprises will be, only that there will be some. A bloody election in Iraq could send oil prices skyrocketing again. The dollar could crash, but it might also bounce back by yearend. And bonds remain a mystery. Long-term rates continue to be surprisingly low even as the Federal Reserve is on the march to raise short term rates and soak up liquidity. At some point, long rates could lurch upward. Or not. Happy New Year.

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earn the same return and sell at the same time,
how does one end up
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